No. 89-924

Supreme Court, U.S.
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# In The Supreme Court Of The United States

OCTOBER TERM, 1989

DAVID P. GOULD, et al.,

Petitioners,

v.

ALLECO, INC., et al.,

Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

## PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

First, whether the petition to intervene by bondholders of an insolvent, and now dissolved, corporation seeking to challenge a proposed settlement that would pay defrauded stockholders in preference to bondholders was timely if made only ten weeks after the proposed liquidation and dissolution of the corporation and one week before the liquidating transaction took place?

Second, whether the bondholders had standing and sufficient interest to permit intervention as a matter of right?

Third, whether the bondholders, who are currently due the entire principal and interest on their debentures, are entitled to payment of the settlement fund in preference to the stockholder fraud claimants?

Fourth, whether the settlement, which provides for the destruction of

25,000 non-public documents, is consistent with the public policy of limited protective orders underlying Federal Rule of Civil Procedure 26?

## LIST OF ALL PARTIES

In addition to the parties listed in the caption of the case, there were a number of other plaintiffs-appellants and defendants-appellees as well as appellants-intervenors and plaintiffs-appellees and defendants-appellees.

In record No. 88-3637, David P. Gould; Marks, Inc.; Lawrence I. Weisman; Phillip Doccolo; Rocko, Inc.; and Patrick L. Day as trustee for James M. Weisman were plaintiffs-appellants while Alleco, Inc.; Morton M. Lapides; Henry Weitz; Edward A. Weisman; Harry J. Conn; David H. Cohen; Robert H. Heller; William D. Houser; Frederic K. Raiff; Arthur F. Staley; David C. Barr; John E. Baker; Jeffry R. Lapides; Heather A. Ditto; Jayme Dorf; Mark A. Garfinkle; David S. Klein; Donn A. Lewis; Jeffrey E. Mann; J. Tighe Merkert; Joan L Nickel; Frank E. Silvestro; Norman B. Weisman; Deborah A

Wenner; C.J. Nelson; Harry J. Kane; Pamela Lapides; Smith, Barney, Harris, Upham & Company; Peat, Marwick, Mitchell & Company, now Peat, Marwick, Main & Company; Laventhol & Horwath; American Security Bank; Perpetual Savings Bank; Squire, Sanders and Dempsey; and Marshall M. Meyer were defendants-appellees.

In record No. 88-3638, Lawrence I. Weisman; David P. Gould; Marks, Inc.; Phillip Doccolo; Rock, Inc.; Patrick L. Day as trustee for James. M. Weisman were appellants-intervenors and Leonard Robinson and Patricia Robinson were plaintiffs-appellees and Allegheny Beverage Corporation; Morton M. Lapides; Henry Weitz; Marshall M. Meyer; Edward A. Weisman; and Harry J. Conn were defendants-appellees.

These two cases were consolidated for purposes of appeal.

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PETITION FOR A WRIT OF CERTIORARI TO
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The petitioners respectfully pray that a Writ of Certiorari issue to review the final judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-captioned proceeding on September 8, 1989.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit holding that bondholders did not have standing to object to the settlement, that the intervenors did not have a sufficient interest to permit intervention of right and that the petition to intervene was not timely is reported at 883 F.2d 281 (4th Cir. 1989) and is reprinted in the appendix at page B-1.

The order of the Court of Appeals denying the petition for rehearing and suggestion for rehearing in banc is reprinted in the appendix at page A-1.

The decision of the District Court denying the petition to intervene and holding the bondholders objections to the settlement invalid, and the reasons for this decision were stated in open court and constitute the opinion of the court.

The relevant portion of the transcript is reprinted in the appendix at page C-1.

The memorandum and order of the United States District Court for the District of Minnesota entering judgment against Alleco, Service America, Lapides Corporation and LP Acquisition Corporation and holding that the interest and principal on the 9 1/2 percent convertible subordinated debentures due 2010 in the amount of $105 million is due immediately is reprinted in the appendix at page D-1.

The Bankruptcy Petition filed against Alleco is reprinted in the appendix at page E-1.

## JURISDICTION

The District Court had original jurisdiction both because of diversity and because the litigants' causes of action arose under federal securities

statutes. The judgment of the Court of Appeals was entered on September 8, 1989. The petition for rehearing filed by appellants was denied September 8, 1989. The jurisdiction of the Court is invoked pursuant to 28 U.S.C 1254(1). The petition has been filed within the time allowed by law.

## STATUTORY PROVISIONS

Most relevant statutory provisions are set forth in the text of the petition. Six statutes or rules are reprinted in the appendix, however, at the pages designated in the table of contents to the appendix.

## STATEMENT OF THE CASE

On July 23, 1986, Leonard and Patricia Robinson sued Allegheny Beverage Corporation and five other defendants on behalf of the class of persons who purchased Allegheny Beverage Corporation stock between May 14, 1985 and June 30, 1986 inclusive, alleging securities fraud under Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 and the common law of Maryland, (S-86-2309). During 1987, Allegheny Beverage changed its name to Alleco, Inc. A settlement agreement was reached whereby Alleco would pay $6.95 million to the plaintiff class. The District Court issued an "Order With Respect to Notice, Settlement Hearing and Administration" on May 17, 1988. That order certified the class pursuant to Rule 23(a) and (b)(3) for purposes of the settlement only. The Stipulation of Settlement was filed with

the court on June 6, 1988. Notice of Proposed Settlement was mailed June 21, 1988 and published in the June 28, 1988 Wall Street Journal. On August 1, 1988, within the period set forth in the District Court's order, petitioners filed an "Opposition of Bondholders to Proposed Settlement". The settlement was opposed because it would pay stockholders in preference to bondholders because Alleco was insolvent and undergoing liquidation. In fact, the Robinson settlement was an integral part of a stepped transaction to dissolve Alleco and take its remaining assets private.

Commencing with a tender offer and liquidation plan instituted on July 13, 1988, of which the Robinson settlement was a key component, Alleco was merged into LP Acquisition Corporation on October 18, 1988, and is no longer a corporate entity of the State of Maryland

or any other state. The assets which had belonged to the public convertible debentureholders and the stockholders of ABC were transferred in full to a corporation called Lapides Corporation (affiliated with LP Acquisition Corporation) of which Morton M. Lapides is the controlling stockholder.

On August 15, David Gould, et al., filed suit against Alleco, Inc., et al. on behalf of the class of persons who purchased or purchased and sold the 9 1/2 percent convertible debentures of Alleco on or after September 1, 1985, for violations of the Securities Act of 1933, Section 10(b) of The Securities Exchange Act of 1934 and Rule 10 (b)(5), for derivative claims against Alleco management, for improperly giving priority to stockholders over bondholders in the payout of a limited Fund, for RICO violations, under the Investment Company

Act of 1940, and alleging the invalidity of the tender offer commenced July 7, 1988. The complaint asked, among other things, that Alleco be declared an investment company within the meaning of the 1940 Act, that a receiver be appointed to take charge of Alleco's assets and those of the Lapides family, that independent counsel be appointed to investigate all claims against Alleco, including whether the Robinson settlement was collusive, that damages be awarded to the plaintiff class, that an injunction be granted enjoining the tender offer, the merger between Alleco and Lapides Corp., and the payment of further Alleco Funds because of the fraudulent actions of Lapides and that Alleco be placed in bankruptcy under Chapter 11.

On September 2, Gould, et al., filed an amended complaint which reiterated the original complaint and made additional

contract and securities fraud claims based specifically on the indentures and taking into account new facts disclosed in Lapides' criminal trial and sentencing before Judge Doumar of the United States District Court for the Eastern District of Virginia and asked for an injunction against the Robinson settlement.

On September 6, Lawrence I. Weisman, et al., moved to intervene pursuant to Rule 24 (a)(2) in the Robinson case and requested a delay of 30 days in the Settlement Hearing. The Motion to Intervene stated that payment of the Robinson settlement may, as a practical matter, make it impossible for the bondholders to obtain full relief since Alleco did not have sufficient net worth to pay the bondholders and the Robinson class.

At the hearing, September 6, 1988, the District Court denied the Motion to

Intervene and Delay Settlement. The Court further issued an order mooting the Gould complaint to the extent it sought relief of any kind against the Robinson settlement. The Court denied the Motion for a Temporary Restraining Order and the motion to place Alleco in receivership.

Less than two years after $105 million of the 9 1/2 percent convertible debentures were issued, ABC attempted to disclaim liability on those debentures on the theory that Servam and Service America Corporation were the substitute obligors. ABC's purported elimination of the conversion rights in a tender offer and merger transaction, which was begun on July 13, 1988 and completed on or about September 13, 1988, caused a catastrophic fall in the market value of those debentures to approximately $55.00 per debenture -- a loss for the public debentureholders of over $50 million.

Petitioners own about $4 million of the 9 1/2 percent debentures.

The issue of whether Alleco has successfully substituted Servam Corporation as the obligor as a result of Alleco's disposition of its Service America Corporation subsidiary and whether Alleco had evaded all liability to remaining Alleco debentureholders was litigated in the United States District Court for the District of Minnesota. Alleco v. IBJ Schroeder Bank & Salomon Brothers; Salomon Brothers intervenor and counterclaim-plaintiff with Alleco, Inc. and Service America Corporation as counterclaim-defendants (3-87-802), and in the Maryland District Court case IBJ Schroder Bank v. Alleco, In., Lapides Corporation, LP Acquisition Corporation and Service America Corporation (88-2170). Action in the latter case was stayed pending the outcome of the

Minnesota litigation.

The Minnesota District Court ruled, conincidently on the same day that the Fourth Circuit handed down its decision, that "Alleco and its controlling shareholder have flaunted the Indenture and have pursued these schemes with utter disregard for the rights of the Debentureholders. This conduct violated numerous terms of the Indenture." The court further held that Alleco was in default and that the principal and interest on the debentures was immediately due and payable. Judgment was entered against Alleco, Service America, Lapides Corporation and LP Acquisition Corporation. App. at D-1.

To the petitioners knowledge, the only remaining asset of Alleco, which is no longer in existence, is the $6.95 million Robinson settlement fund at issue in this case. Thus, precisely the

inability to pay that was the foundation of petitioners original petition to intervene has come to pass.

## REASONS FOR GRANTING THE WRIT

### A. THE PETITION TO INTERVENE BY BONDHOLDERS OF AN INSOLVENT, NOW DISSOLVED, CORPORATION AGAINST A PROPOSED SETTLEMENT THAT WOULD PAY DEFRAUDED STOCKHOLDERS IN PREFERENCE TO BONDHOLDERS WAS TIMELY IF MADE ONLY EIGHT WEEKS AFTER THE PROPOSED LIQUIDATION AND DISSOLUTION OF THE CORPORATION AND ONE WEEK BEFORE THE LIQUIDATING TRANSACTION TOOK PLACE.

The appellants filed an objection to the settlement on August 1, 1988, sought to enjoin the settlement on September 2, 1988 and sought to intervene in this case on September 6, 1988. The intervention was sought ten weeks after the notice of proposed settlement was mailed to the class on June 21, 1988, nine weeks after notice by publication in the June 28 Wall Street Journal, eight weeks after the announcement of the liquidating transaction on July 13, 1988, and one week before the liquidating transaction was completed. The motion to intervene was timely within the meaning of Rule 24(a). On many occasions courts have even

allowed post-judgment interventions. See, e.g. United Airlines, Inc. v. McDonald, 432 U.S. 385, 53 L.Ed 2d 423, 97 S.Ct. 2462 (1977) at note 16. Moreover the cases make it clear that the timeliness requirement should be liberally construed with respect to interventions of right as compared to permissive interventions. See Hardy-Latham v. Wellons, 415 F.2d 674 (4th Circuit 1968); Fleming v. Citizens for Albermarle, 577 F.2d 236 (4th Circuit 1978) cert. denied 439 U.S. 1071, 99 S. Ct. 842, 59 L.Ed.2d 37 (1979). The District Court ruled that the intervention was not timely.

The Court of Appeals accepted the reasoning of the District Court. Both courts focused on the period of years that had elapsed since the original Robinson action was filed. The Court of Appeals' analysis centers on May 17, 1988 -- the date that the proposed settlement

was presented to the District Court. But that date is utterly irrelevant. The relevant period is the period elapsing between the date that the liquidating transaction was announced, July 13, 1988 and the date that the petition to intervene was filed, September 6, 1988 -- a period of less than seven weeks. Before the liquidation was announced, bondholders were not facing the prospect that their creditor, Alleco, would simply dissolve in violation of the Indenture and leave them without recourse. The liquidating transaction occurred September 13, 1988, one week after the petition to intervene and the corporation ceased to exist on November 9, 1988, eight weeks after the petition to intervene.

**B. THE BONDHOLDERS HAD STANDING TO INTERVENE AND A SUFFICIENT INTEREST TO PERMIT INTERVENTION AS A MATTER OF RIGHT.**

ANY OTHER INTERPRETATION ALLOWS PUBLIC COMPANIES' MANAGEMENT TO GO PRIVATE, PAYING DISSIDENT STOCKHOLDERS, AND LEAVING THEIR PUBLIC DEBENTUREHOLDERS WITH RECOURSE ONLY TO HIGHLY LEVERAGED AND INSOLVENT SUBSIDIARIES. MOREOVER, AN UNDULY NARROW INTERPRETATION OF STANDING AND INTEREST REQUIREMENTS IN CLASS ACTION LITIGATION GENERALLY WILL ALLOW INSOLVENT FIRMS TO FAVOR SOME CREDITORS AT THE EXPENSE OF OTHERS IN DEROGATION OF THE PUBLIC INTEREST.

The District Court appeared to accept the allegation of Respondent's counsel that neither debenture holders nor other non-members of the class could intervene in a settlement proceeding. The Court of Appeals explicitly held that "non-class members have no standing to object, pursuant to Rule 23(e) notice directed to class members, to a proposed class settlement. Interjection of the opposing views of non-class members should proceed via intervention under Rule 24." App. at B-10.

Over the years, various appellate courts have pointed out that

Rule 23(e) of the Federal Rules of Civil Procedure imposes an independent duty upon the approving court to protect the public and those parties who are not before the Court. Rule 23(e) is not designed to protect merely members of the class chosen by plaintiffs' counsel. It is designed to protect parties with an interest in the funds before the Court as defined in Rule 24(a)(2) of the Federal Rules of Civil Procedure as well as necessary parties as defined by Rule 19(a)(2) of the Federal Rules of Civil Procedure. These guidelines are particularly important in a case like this where a class is not certified prior to settlement. Moreover, courts have given non-class members "standing" to object to settlements.

One of the best illustrations of the reason for the rule is found in Piambino v. Bailey, 757 F.2d 1112 (11th

circuit, 1985). In that case, a state court class had obtained a judgment before a federal court class had been certified. Eventually the federal court class succeeded in having the state court judgment set aside in its own favor. Upon intervention on behalf of the state court class, the federal court judgment, certification of class, and award of attorneys fees was reversed by the Court of Appeals for the Eleventh Circuit in a stinging rebuke which might well be read to apply to this case.

The Court brushed aside objections to the settlement on the grounds that the intervenors had no standing.

> "The district court approved Lead Counsel's proposed attorney's fee because 'no one opposed it'; Sylva's objection did not count because he was not a party. Such perfunctory approval, the Piambino I panel held, constituted a complete abdication by the court of 'its responsibility to assess the

> reasonableness of attorney's fees proposed under a settlement of a class action,' 610 F.2d at 1328, and, standing alone, was sufficient to vitiate the settlement. Id. Of course, the settlement was also invalid because of its highly prejudicial treatment of the Minority Group.
>
> The Rule 23 policies that dictate the conduct of the trial judge and plaintiffs' counsel in class actions simply cannot accommodate the decision Lead Counsel urge us to make, which would allow Lead Counsel and the settling plaintiffs to retain the proceeds of the Bestline settlement." Piambino v. Bailey, 757 F.2d 1112, 1140.

In In Re Pittsburgh and Lake Erie Railroad Company, 543 F.2d 1058 (3rd Circuit, 1976) Irving Trust Company was the trustee under an indenture by the Pennsylvania Railroad (Penn Central). Penn Central, before its bankruptcy, pledged 22.5% of P&LE's stock to Irving as trustee for the Penn Central debentureholders.

During the course of the Penn Central bankruptcy, shareholders class action and derivative actions were brought on behalf of P&LE's minority stockholders who held approximately 7% of P&LE's stock.

Settlement was made between Penn Central, the minority and derivative stockholders, and certain officers and directors of P&LE. All parties contended that the Third Circuit could not disapprove a settlement because Irving was a nonparty just as all respondents in this case claim that the petitioners are non-parties.

The Third Circuit disagreed and held not only that Irving had standing to be heard on its objection to the settlement but that the District Court abused its discretion in approving the settlement. In substance, Irving stated that its bondholders were under-secured just as

the convertible debentureholders are in this case and the Third Circuit found also that the proposed settlement "would delete pledgee's equity in P&LE by approximately $472,500 and would further deplete the net working capital of P&LE".

The Court of Appeals for the Third Circuit, in contrast to the Fourth Circuit, found that Irving's standing to objection to the settlement depended upon whether the security of its bondholders would be adversely affected by the implementation of the settlement. The Third Circuit found, just as the petitioners have argued with respect to Alleco in this case, that Irving Trust had a duty not only under the common law but also under the Trust Indenture Act of 1939.

> We have often said that in reviewing a court-approved settlement we utilize an abuse of discretion standard. In this case, for a minimal if not

> non-existent benefit to P&LE, the settlement costs that corporation $2,100,000. The actual benefits flow only to plaintiffs' attorneys and the 7% minority stockholders. The form of the settlement assumes that only Penn Central, the chief beneficiary of the alleged wrongdoing, is interested in the other 93%. It ignores the patent reality that as to the 22.5% of P&LE stock, Penn Central's interest is, in an equitable sense, slight or non-existent. It ignores the conflict of interest between Penn Central as pledgor and alleged wrongdoer and Irving as innocent pledgee. We have no hesitation in holding that the district court's approval of this settlement was an abuse of discretion. In Re Pittsburgh and Lake Erie Railroad Company, 543 F.2d 1058 (3rd Circuit, 1976)

The petitioners should have been allowed to intervene as a matter of right. Federal Rule of Civil Procedure 24 states:

> **(a) Intervention of Right. Upon timely application anyone shall be permitted to intervene in an action: (1) when a statute of the United States**

> confers an unconditional right to intervene; or (2) when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.

The District Court ruled that "to say that a shareholder who is not a member of the class or a general creditor or trade creditor or a holder of a debt instrument can intervene with regard to the fairness hearing portion of a class action settlement is not an appropriate construction of Rule 24. I don't think it allows any such thing." App. at C-3. It

is difficult to think of any more appropriate construction of Rule 24 than when bondholders are trying to protect their superior interests against shareholders in the case of an insolvent corporation with a limited fund. The rule has been so construed in the past by other courts. Cf. In Re Pittsburgh and Lake Erie Railroad Company, 543 F.2d 1058 (3rd Circuit, 1976) discussed above.

Intervenors must meet a three part test. First, the proposed intervention must have merit. Second, in the absence of intervention, the interest may be impaired. Third, the present litigants must not adequately represent the interest. United Guaranty Residential Insurance Company v. Philadelphia Savings Fund, et al., 819 F.2d 473 (4th Circuit, 1987); Virginia v. Westinghouse Electric, 542 F.2d 214, 216 (4th Circuit, 1976).

Petitioners meet these three tests.

First, the intervenors' case has merit, as the Minnesota District Court decision demonstrates. Second, the petitioners will probably lose, dollar for dollar, everything paid to the Robinson class and its lawyers since Alleco is insolvent, dissolved and now a bankruptcy petition is pending. Third, the present litigants' interests are diametrically opposed, given the situation, to those of the creditors.

Respondents and the Court of Appeals, at App. B-1, placed great reliance on Kusner v. First Pennsylvania, et al, 74 F.R.D. 606 (1977), aff'd. 577 F.2d 726 (3rd Circuit, 1978). That case is inapposite. First, petitioners are intervening under Rule 24, rather than Rule 23(d) under which Kusner was decided. Second, the facts in Kusner are the reverse of this case. In that case, a stockholder of a solvent corporation

tried to stop a settlement with debentureholders. In this case debentureholders are trying to stop a settlement paying stockholders of an insolvent corporation.

In Securities Exchange Commission v. Flight Transportation Corporation, 699 F.2d 943 (8th Circuit, 1983), the Securities and Exchange Commission brought a fraud action against a group of defendants. Greyhound Leasing and Financial Corporation brought a motion to intervene as a matter of right under Rule 24(a)(2). The trial judge denied their motion stating that their interests had not been shown to be "adversely affected" and were hypothetical. The Eighth Circuit Court of Appeals, in contrast to the Fourth Circuit, reversed the denial of intervention. It pointed out that "as a practical matter FTC has no assets other than the $22 million the SEC

seeks." Greyhound had also met the 'single minimal' burden of showing that its interests may not be adequately represented by existing parties". Greyhound had a "disparate" interest to warrant intervention, namely its interest in protecting its rights as a lessor which as a practical matter was foreclosed since the corporation involved would have no assets left to protect Greyhound's security interest. See also, Trbovich v. United Mine Workers of America, 404 U.S. 528, 538 (n.10), 925 S.Ct. 630, 30 L.Ed.2d 686 (1972).

It was probably only Alleco's debenture holders whose claim of about $4,000,000 was as large as the class settlement who had standing to raise the bondholder issues as opposed to the trustee. In In Re Equity Funding Corporation of America Securities Litigation, Chemical Bank as Indenture

Trustee, et al. Appellants v. Sylvia Confino, et al as Representative of the Plaintiff classes Appellees, 603 F.2d 1353 (9th Circuit 1979), the Court of Appeals for the Ninth Circuit dealt with the standing of Chemical Bank. It pointed out that Chemical Bank was not a member of the plaintiff classes in the MDL securities litigation and added that "*** nor is it otherwise a claimant to any portion of the settlement fund." The question, therefore, arises as to its standing to object to the plan of allocation and to appeal from the order of the MDL court approving the offset provision of said plan ***", 603 F.2d 1353. The Ninth Circuit panel pointed out that neither Chapter 11 of the old Bankruptcy Act nor any of the Supreme Court decisions nor the Trust Indenture Act of 1939, gave Equity Funding standing to issues as to between debenture holder

classes of security holders and stockholder classes of security holders. The Ninth Circuit Panel held that Chemical Bank could not be a representative in the class action but that, on the contrary, the debenture holders class was properly represented by class representatives appointed by the trial court. Likewise in this case, the conclusion is correct that in arguments between classes, the indenture trustee has no standing but only bondholder members. The Ninth Circuit concluded its discussion of standing by stating, "Consequently, we agree with the MDL Court that Chemical Bank lacks standing to object to or appeal from the plan of allocation or its approval by the court below. However, the individual appellants as debenture holders and members of the plaintiff class clearly had standing to object for the purposes of this appeal.

We, therefore, turn to their arguments."

If the Fourth Circuit's narrow interpretation of the right of non-class members to object to a settlement or to intervene is allowed to stand, then public companies' management will be able to go private, paying dissident shareholders but leaving their public debentureholders with recourse only to highly leveraged and insolvent subsidiaries. It is important, particularly with the ever-increasing degree of leveraged and management buy-out activity that bondholders be afforded an adequate opportunity to be heard. Moreover, this vary narrow interpretation will have an adverse impact on the ability of many persons in other kinds of litigation to protect their rights.

**C. THE SETTLEMENT FUND SHOULD NOT BE PAID IN DEROGATION OF THE RIGHTS OF THE DEBENTURE HOLDERS. ANY OTHER RULE ALLOWS**

PUBLIC COMPANIES' MANAGEMENT TO GO PRIVATE, PAYING DISSIDENT STOCKHOLDERS, AND LEAVING THEIR PUBLIC DEBENTUREHOLDERS WITH RECOURSE ONLY TO HIGHLY LEVERAGED AND INSOLVENT SUBSIDIARIES.

1. PAYMENT OF THE SETTLEMENT FUND WOULD IMPROPERLY COMPLETE THE DISSOLUTION AND LIQUIDATION OF ALLECO CONTRARY TO LAW

The Settlement fund should not be paid because payment would, in effect, distribute the last remaining assets of a dissolved and liquidated corporation to the shareholders in preference to the legitimate claims of the debenture holders.

Alleco was dissolved effective November 9, 1988. At that time, all of Alleco's assets except for the Settlement Fund were paid to Alleco's sole remaining shareholder, Lapides. If the Fund is also now paid to the shareholders, this would complete the dissolution and liquidation of Alleco by distribution of all of the assets to shareholders without

paying the claims of any creditors, including petitioners and other debentureholders.

Section 3-410(b) of the Maryland General Corporation Law provides that when a corporation is dissolved, the directors shall

> (1) Collect and distribute the assets, applying them to the payment, satisfaction, and discharge of existing debts and obligations of the corporation, including necessary expenses of liquidation; and
> (2) Distribute the remaining assets among the stockholders.

Section 3-412 provides for distributions to shareholders in a voluntary dissolution "[i]f. . .assets are available for distribution to stockholders."

Maryland Corporations and Associations Section 3-419(a) states:

> (a) Liability in general. -- The voluntary or involuntary dissolution of a corporation does not

> relieve its stockholders, directors, or officers from any obligation or liability imposed on them by law.

Thus Alleco and the Robinson stockholders cannot avoid their liability to bondholders simply by dissolution. A corporation may not pay a dividend (Section 2-309) or acquire its own stock (Section 2-312(c)) if it is insolvent. That is precisely what the Robinson settlement constitutes.

The effect of these provisions is to prohibit a dissolved Maryland corporation from distributing assets to the shareholders until obligations to creditors have been satisfied. Distributing the Settlement Fund to the shareholders in this case without first paying the creditors constitutes an evasion of this statutory obligation.

2. THE SHAREHOLDERS ARE NOT ENTITLED TO PRIORITY PAYMENT AS TORT CREDITORS OF ALLECO

Although the shareholders have also asserted tort claims against Alleco, this does not convert them from shareholders to creditors who are entitled to be paid ahead of the debenture holders in the liquidation of Alleco.

Section 510(b) of the Bankruptcy Code, 11 U.S.C. Section 510(b), provides for the subordination of fraud claims of shareholders to the claims of other creditors. The statute states:

> "(b) For the purpose of distribution under this title [11 USC Subsection 101 et seq.], a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 [11 USC Section 502] on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common

> stock, such claim has the same priority as common stock."

In Re Flight Transportation Corporation Securities Litigation, 730 F.2d 1128 (1984) makes the meaning of the section clear:

> According to this view, since 'the unsecured creditor [relies] of an apparent cushion of equity securities in making the decision to extend credit,' the risk of illegality in securities issuance should be borne by the securities purchasers, not the general creditors. House Report at 195, U.S.Code Cong. & Admin. News 1978, p. 6155. 'The general creditors have not had the potential benefit of the proceeds of the enterprise deriving from ownership of the securities and it is inequitable to permit shareholders that have had this potential benefit to shift the loss to general creditors.'

This provision is made applicable to the dissolution of Maryland corporations outside of bankruptcy by Maryland General Corporation Law Section 3-418(b) which provides:

> (1) Any preference, payment, or transfer made by the corporation which would be void, voidable or fraudulent under State law or the federal Bankruptcy Act if made by an insolvent or bankrupt is to the same extent void, voidable, or fraudulent, respectively, as to the corporation, and the receiver has the powers of a trustee in bankruptcy with respect to setting them aside.

The clear intent of this provision is to make the Bankruptcy Code applicable to a determination of the duties of the corporation and its owners to creditors.

Although the provision applies by its terms only to corporations in receivership, the same rules apply to insolvent corporations whether or not they are in receivership. Moreover, Alleco presently has a bankruptcy petition pending against it, filed on October 11, 1989. Under Maryland law, "In insolvency distributions, creditors have priority over shareholders," Chevy Chase

Savings & Loan v. State, 306 Md. 384, 402, 509 A.2d 670 (1986). There is no doubt that Alleco has liabilities -- including those to the debenture holders -- vastly in excess of its remaining assets, and therefore is "insolvent" under Section 2-301 of the Maryland General Corporation Law. It follows that because the Bankruptcy Code is applied under Maryland law to insolvent corporations that it would be unlawful to give defrauded shareholders priority over other creditors.

Equity Funding Corporation v. Sylvia Confino, et al., 603 F.2d 1353 (9th Circuit, 1979) shows that in a class action distribution, fraud claimants such as the Robinson stockholders and their attorneys are subordinated to holders of subordinated debt instruments. The fraud claimants are listed as Class 8 claimants whereas the holders of subordinated debt

instruments are listed as Class 7 instruments. Under the absolute priority rule of bankruptcy, the fraud claimants would be entitled to nothing. However, in order to avoid a dispute as to the value of previously distributed securities, Equity Funding debenture holders permitted a 12.3% recovery to security holders.

In Matter of Stirling Homex Corp., 579 F.2d 206, (2nd Circuit, 1978), defrauded common stockholders got nothing until general creditors were paid, whether subordinated or not.

Under the rules of distribution between unsecured creditors and stockholders who were defrauded whether in bankruptcy or in class action litigation, the defrauded stockholders and their attorneys get nothing until the unsecured creditors are paid in full.

3. APPROVAL OF THE SETTLEMENT WAS UNFAIR TO THE DEBENTURE HOLDERS BECAUSE DEBENTUREHOLDERS HAVE SUPERIOR INTERESTS AND BECAUSE THEY ARE TORT-CLAIMANTS ON AN AT LEAST EQUAL FOOTING WITH SHAREHOLDERS.

Even if the shareholders should be considered tort victims for purposes of determining their priority, this should not entitle them to payment ahead of debenture holders because the latter are victims of the same fraudulent conduct that injured the shareholders. They have sought redress for these wrongs in the District Court.

The petitioners have asserted substantial tort fraud claims against Alleco. These claims include, inter alia, allegations that the prospectus for the issuance of the convertible debentures contained numerous misstatements and omissions; that individual defendants engaged in numerous improper transactions that amounted to a

looting of Alleco; that individual defendants engaged in a price-fixing conspiracy that cost Alleco millions of dollars; that Alleco failed to report substantial liabilities to Waste Management Corporation; and that Alleco committed undisclosed federal income tax fraud.

Furthermore, as demonstrated above, payment of the Settlement Fund contravenes the Debentureholders' rights to participate in the liquidation of Alleco. The settlement -- including the provision for payment of the Fund -- should never have been approved. The courts have recognized that in approving a settlement, the rights of all corporate claimants, and not merely the class members who will benefit from the settlement, should be considered.

This principle is embodied not only in the cases concerning standing to

object to the settlement but also in the standards for approval of the settlement. Thus, in In re Warner Communications Securities Litigation, 798 F.2d 35 (2d Cir. 1986), the court approved the settlement of securities fraud and corporate claims. But Judge Newman, concurring, cautioned:

> settlement might well be shown to be unreasonable to a shareholder if the corporate defendant contributed so much more than a fair share as to cause a discernible incremental pro rata decline in the value of the stockholders stock below the reduction attributable to a fair contribution. That possibility is not present in this case because the Delaware Court of Chancery, in approving the settlement of the derivative action, determined that the allocation of burdens between the Corporation and the individuals was fair. In the absence of adjudication or judicially approved settlement of a parallel derivative action, however, assessment of the fairness of a shareholder's action would require some scrutiny of the fairness of the corporation's contribution.

In the present case, there has not only not been an adjudication of the allocation of burdens between shareholders and creditors, but there has not even been a hearing on the creditors' claims. The Corporation now proposes to pay everything to the shareholders. That is precisely the situation Judge Newman was worried about.

D. THE SETTLEMENT, WHICH PROVIDES FOR THE DESTRUCTION OF 25,000 NON-PUBLIC DOCUMENTS, IS INCONSISTENT WITH THE PUBLIC POLICY OF LIMITED PROTECTIVE ORDERS UNDERLYING FEDERAL RULE OF CIVIL PROCEDURE 26.

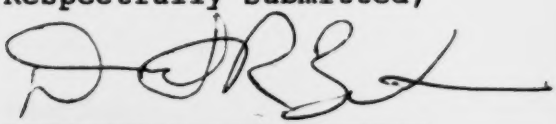
The settlement provides for the destruction of 25,000 non-public documents, is inconsistent with the public policy of limited protective orders underlying Federal Rule of Civil Procedure 26. Those 25,000 documents should be available to other tort-claimants with substantially the same

cause of action. Requiring every litigant with similar causes of action, debentureholders in this case, to "reinvent the wheel" raises the costs of litigation needlessly and will often make the cost of plaintiffs' vindicating their just rights prohibitive. This problem has recently received particular attention in the context of product liability litigation. See, 75 American Bar Association Journal 32 (November, 1989). Rule 26 recognizes the desirability of an open litigation process by requiring litigants to show good cause before they can secure a protective order sealing documents. Petitioners contend that the provision in the settlement that would provide for the secret destruction of 25,000 documents is invalid and should be disapproved.

## CONCLUSION

For these reasons, the petition for a writ of certiorari should be granted.

Respectfully Submitted,



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## FILING AND MAILING CERTIFICATE

I, Barbara E. Grove, hereby certify that on this 7th day of December, 1989, I filed with the Clerk's Office of the United States the foregoing Petition for a Writ of Certiorari and further certify that I mailed this same date the required copies to the opposing counsel listed below:

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No. 89-924

Supreme Court, U.S.
FILED
DEC 7 1989
JOSEPH F. SPANIOL, JR.
CLERK

# In The Supreme Court Of The United States

OCTOBER TERM, 1989

DAVID P. GOULD, et al.,

Petitioners,

v.

ALLECO, INC., et al.,

Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

## APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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# APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 88-3637

DAVID P. GOULD, et al

Plaintiffs - Appellants

v.

ALLECO, INC., et al

Defendants - Appellees

No. 88-3638

In Re: LAWRENCE I. WEISMAN, et al

Appellants

---

LEONARD ROBINSON, et al

Plaintiffs - Appellees

v.

ALLEGHENY BEVERAGE CORP., et al

---

On Petition for Rehearing with Suggestion for Rehearing in Banc

---

The appellant's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing in banc are denied.

Entered at the direction of Judge Hall with the concurrence of Judge Ervin and Judge Wilkinson.

For the Court,

JOHN M. GREACEN
Clerk

# APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

---

No. 88-3637

---

DAVID P. GOULD, et al

Plaintiffs - Appellants

versus

ALLECO, INC., et al

Defendants - Appellees

---

No. 88-3638

---

In re: LAWRENCE I. WEISMAN, et al

Appellants

LEONARD ROBINSON, et al

Plaintiffs - Appellees

versus

ALLEGHENY BEVERAGE CORP., et al

Defendants - Appellees

---

Appeal from the United States District Court for the District of Maryland, at Baltimore. Frederic N. Smalkin, District Judge (CA-88-2399) (C/A 86-2309-S)

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Argued:
April 13, 1989

Decided:
August 16, 1989

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Before ERVIN, Chief Judge, and HALL and WILKINSON, Circuit Judges.

---

David Reed Burton for Appellant. Bruce K. Cohen (MEREDITH & COHEN, P.C. on brief) Stephen Howard Glickman (Leslie A. Blackmon, ZUCKERMAN, SPAEDER, GOLDSTEIN, TAYLOR & KOLKER; A. Raymond Randolph, Daniel I. Prywes, PEPPER, HAMILTON & SCHEETZ; Steven A. Allen, DAVIS, WEIKEL & ALLEN on brief) for Appellees.

HALL, Circuit Judge:

Lawrence I. Weisman and two others appeal from the denial of a motion to intervene in Robinson v. Allegheny Beverage Corporation, CA No. S-88-2399 (D. Md.) and from the order approving a class settlement of the same case. Weisman also appeals from the district court's refusal to address his objections to the settlement proposal. The district court determined that the motion to intervene in the class action was not timely filed and that the appellants lacked standing to object to the proposed class settlement or to intervene in the action itself. Finding that the district court correctly decided each of these issues, we affirm.

I.

In July, 1986, Allegheny Beverage Corporation was sued by Robinson and six

other persons who had purchased Allegheny stock during a prior thirteen-month period. The complaint claimed violations of federal securities laws and state common law for alleged fraud by the company's officers in inflating the stock's price. Robinson was consolidated with two other similar actions, and almost two years of litigation culminated in a proposed "Stipulation of Settlement" which was presented to the district court on May 17, 1988. This proposal contemplated payment of $6.95 million to the plaintiff class. The court preliminarily approved the settlement, certified the class for settlement purposes, scheduled a hearing for September 6, 1988, to consider the fairness of the proposal, and set August 1, 1988, as the deadline for the filing of objections by class members to the proposal. Notice of the settlement was

mailed to each member of the class and was published in the Wall Street Journal.

No class members objected to the settlement but Weisman, an Allegheny bondholder, filed an "opposition" in August 1 on behalf of all owners of bonds issued by the company. The crux of Weisman's objection was that bonds, whose rights to payment he alleged to be superior to the rights of stockholders, would be harmed because the Robinson settlement would dilute the conversion value of the bonds by depleting the company's assets. The company and the named plaintiffs filed responses to the objection; Weisman, however, failed to reply although given the opportunity to do so.

On August 15, 1988, Weisman and five others filed a complaint in the district court against the company and thirty-three other defendants claiming, among

other things, $200 million in compensatory damages and $500 million in punitive damages for alleged violations of federal securities law. Gould v. Alleco, Inc.\1 C/A No. B88-2399 (D. Md.). On August 24, the district court notified all parties in both cases that any requests for injunctive relief in the Robinson case would be entertained at the September 6 settlement hearing.

On September 2, the Gould plaintiffs filed a 155-page amended complaint which included a request to enjoin the Robinson settlement. The basis of the request was the Gould plaintiffs' contention that payment of the settlement would impair the company's ability to satisfy any judgment which might be rendered against

---

\1 In the intervening period between the filing of the Robinson complaint and the Gould complaint, Allegheny Beverage Corporation changed its name to Alleco, Inc.

it in Gould.

Moments before the commencement of the September 6 hearing, counsel for the Robinson parties were served with copies of the amended Gould complaint and with a motion by Weisman and two other Gould plaintiffs to intervene in the Robinson case and to delay the approval of the settlement. After extended argument, the district court denied the motion to intervene on the grounds that it was untimely under Fed. R. Civ. P. 24(b) and, alternatively, that the would-be intervenors lacked standing. The court disposed of Weisman's August 1 objection to the settlement on the grounds that Weisman was not a member of the class and, therefore, had no standing to object. The court then approved the settlement and noted that such action mooted any claims for injunctive relief against approval sought by the Gould

plaintiffs.\2

This appeal followed.

II.

On appeal, the appellants contend that the lower court erred in ignoring Weisman's objections to the settlement proposal and in denying the motion to intervene on standing and timeliness grounds. Weisman and the other intervenor-appellants also address the merits of the settlement proposal. ___

---

\2 Although the notice of appeal in 88-3637 states that the Gould plaintiffs were appealing from the lower court's "September 6, 1988, denial of a preliminary injunction and other relief with respect to the proposed settlement," the appellants' brief in this consolidated appeal does not address the lower court's actions regarding Gould. Thus, the lower court's denial of the relief requested in Gould, i.e., to enjoin the settlement or to appoint a receiver, is affirmed. We note that the complaint in Gould was subsequently dismissed on the ground that it violated Fed. R. Civ. P. 8(a) (short and plain statement).

Because our resolution of the intervention/objection issues is completely dispositive, however, we do not reach the issue of the propriety vel non of the settlement itself.

The lower court held that Weisman had no standing to intervene or to object. Although both the August 1 objection and the intervention motion had identical purposes, i.e. to delay or halt the Robinson settlement, resolution of each requires a slightly different analysis. We begin with a discussion of the August 1, 1988, "opposition" or objection filed by Weisman on behalf of himself and other bondholders.

A.

Fed. R. Civ. P. 23(e) requires that notice of any proposed settlement of a class action be given to "all members of the class in such manner as the court directs." No one argues that the manner

of notice was deficient in any respect; Weisman, however, contends that his August 1, 1988, "opposition" to the settlement should have required the court to reach the merits of his objection. We disagree. The plain language of Rule 23(e) clearly contemplates allowing only class members to object to settlement proposals. Kusner v. First Penn Corp., 74 F.R.D. 606, 610 n.3 (E.D. Pa. 1977), aff'd 577 F.2d 726 (3rd Cir. 1978); Jenson v. Continental Financial Corp., 591 F.2d 477, 482 n.7 (8th Cir. 1979). Beginning from the unassailable premise that settlements are to be encouraged, it follows that to routinely allow non-class members to inject their concerns via objection at the settlement stage would tend to frustrate this goal. Were the rule as Weisman contends, every objection from a non-class member would trigger an examination by the court of the effects

of the proposal on the objector. Kusner, at 611. We cannot conceive that the drafters of the Rules intended to permit such eleventh-hour expansion of class actions. We hold, therefore, that non-class members have no standing to object, pursuant to a Rule 23(e) notice directed to class members, to a proposed class settlement. Interjection of the opposing views of non-class members should proceed via intervention under Rule 24.\3 We proceed, then, to a discussion of the motion by the Weisman intervenors.

B.

Rule 24(a)(2), "Intervention of Right," requires the court to allow intervention when, upon timely

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\3 Our ruling regarding the lack of standing of non-class members to object to proposed settlements should not be read to restrict the trial court's authority to consider or even solicit the views of non-parties to proposed class settlements.

application,

> . . . the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter imkpair or impede the applicant's ability to protect that interest unless the applicant's interest is adequately represented by existing parties.

Thus, in addition to timeliness, intervention is dependent on the moving party's fulfillment of three requirements: interest, impairment of interest and inadequate representation. 3B J. Moore, Moore's Federal Practice, 24.07(a) (2d ed. 1987); United Guar. Res. Ins. Co. v. Philadelphia Sav. Fund, 819 F.2d 473, 474 (4th Cir. 1987). The district court's denial of the intervention motion for failure to meet these requirements will only be disturbed if an abuse of discretion is found. Virginia v. Westinghouse Elect. Corp.,

542 F.2d 214, 216 (4th Cir. 1976); Aluminum Co. v. Utilities Comm. of State of N.C., 713 F.2d 1024, 1025, n. 1 (4th Cir. 1983); Southern Christian Leadership v. Kelley, 747 F.2d 777, 779 (D.C. Cir. 1984); contra Mothersill D.I.S.C. Corp. v. Petroleos Mexicanos, S.A., 831 F.2d 59, 61-62 (5th Cir. 1987) (district court's conclusions about Rule 24(a)(2) requirements other than timeliness are questions of law and reviewable de novo); Getty Oil Co. v. Dept. of Energy, 865 F.2d 270 (Em. App. 1988) (adopting a "sensible blend" of standards of review).

In analyzing whether the Weisman intervenors meet these requirements, we will assume that their interests, such as they are, were not "adequately represented by existing parties." It is on the interest requirement of Rule 24(a) that the Weisman intervenors come up short. We interpret the district court's

use of the term standing to implicate Rule 24's interest requirement.

Cases involving non-class members' attempts to intervene and/or object to settlements are few, and the courts usually reject the outsiders' attempts to enter the litigation during the settlement phase. See e.g., Kusner, 74 F.R.D. 606; Jones v. Amalgamated Warbasse Houses, Inc., 97 F.R.D. 355, 360 (E.D.N.Y. 1982), aff'd 721 F.2d 881 (2nd Cir. 1983), cert. denied, 466 U.S. 944 (1984); Quad Graphics, Inc. v. Fass, 724 F.2d 1230 (7th Cir. 1983). Weisman sought to intervene in Robinson under Rule 24(a)(2), and there is no indication that this rule is not applicable to class actions. Therefore, we reject the blanket proposition advanced by the appellees that the bondholders, solely by virtue of their non-inclusion in the Robinson class, have no standing as a

matter of law to intervene to insure that their interests are protected. It is, rather, on the facts of this case upon which our decision rests.

The motion to intervene incorporated by reference the complaint in Gould (the three would-be intervenors were also among the six plaintiffs in Gould). Reduced to its essence, the grounds asserted in support of the motion are these: (1) according to the terms of the debenture instrument, the intervenors, in their capacity as bondholders, have a superior interest in Alleco's assets to that of the Robinson plaintiffs; and (2) as Gould plaintiffs, they have potential judgment claims against Alleco, full payment of which would be impaired if the Robinson settlement is permitted to proceed. Thus, the motion concludes, "just allocation of the claims against Alleco, Inc. requires that the

Intervenors be permitted time to demonstrate to this Court a just and effective process for handling priority of claims among those pursuing relief from Alleco, Inc."

The bond indenture does limit Alleco's right to declare dividends and to make distributions on capital stock under certain circumstances. What the appellants fail to appreciate is that the Robinson plaintiff class is not composed of stockholders qua stockholders; rather, these plaintiffs sued on the basis of alleged fraud related to their purchase of stock during a specific period in the past. The settlement fund represents damages, not stock distributions. The fact of prior stock ownership does not serve to bring the settlement within the indenture restrictions.

The Gould complaints sought damages and other relief for federal securities

law violations and various state fraud violations. The gist of the argument is that payment of the $6.95 million settlement would deplete the assets of Alleco to the prejudice of the Gould plaintiffs in the event they were successful in their suit. Merely claiming a general interest in Alleco's assets based on a speculative recovery in an unrelated civil action does not, however, satisfy Rule 24's requirement that the claim be "relating to the property or transaction which is the subject of the action." If the intervenor's theory is correct, every proposed settlement would be subject to derailment as long as a potential judgment creditor decided to intervene. Kusner, 74 F.R.D. at 611. In a sense, every company's stockholders, bondholders, directors and employees have a stake in the outcome of any litigation

involving the company, but this alone is insufficient to imbue them with the degree of "interest" required for Rule 24(a) intervention. On the facts presented by this record, we find that the lower court did not abuse its discretion by ruling that the intervenors had an insufficient interest for Rule 24(a) purposes.

III.

The district court also determined that the intervention motion should be denied on the grounds that it was not timely filed. Both intervention of right and permissive intervention require "timely application." Fed. R. Civ. P. 24(a), (b). The Supreme Court has held that this timeliness requirement is determined by a court in the exercise of its discretion and that a ruling will not be disturbed on appeal unless this discretion is abused. NAACP v. New York,

413 U.S. 345, 365-66 (1973). This Circuit has stressed the importance of timeliness and the wide discretion afforded the district courts. Brink v. DaLesio, 667 F.2d 420, 428 (4th Cir. 1981). The Weisman motion is outside even the most indulgent standard of timeliness.

The courts are in general agreement regarding the considerations relevant to determinations of the timeliness of an intervention motion. A reviewing court should look at how far the suit has progressed, the prejudice which delay might cause other parties, and the reason for the tardiness in moving to intervene. Commonwealth of Pa. v. Rizzo, 530 F.2d 501, 506 (3rd Cir. 1976)(, cert. denied, Fire Officers Union v. Pennsylvania, 426 U.S. 921 (1976); Neville v. BBOC, 511 F.2d 303, 305 (8th Cir. 1975). Each of these considerations militates against

the motion. We will discuss each in turn.

The initial complaint in Robinson was filed on July 23, 1986, more than two years prior to the filing of the intervention motion. Two years of extensive litigation and settlement negotiations culminated in the settlement proposal presented to the court on May 17, 1988. Three and one-half months later, at the last possible moment, the intervention motion was filed. The tardiness of the motion is the strongest reason supporting its denial.

In United Airlines, Inc. v. McDonald, 432 U.S. 385 (1977), the Supreme Court held that a putative class member's post-judgment motion to intervene, for the sole purpose of appealing the court's earlier denial of class certification, was timely because it was filed within the time permitted

for appeal of the judgment. The Court emphasized that intervention prior to the entry of final judgment would have served no purpose whatsoever and would have tended to frustrate Rule 23's goal of judicial economy. Id. at 394 n.15. The Court also pointed out that, prior to the intervention request, the intervenor reasonably relied on the named class representatives to protect her interests. Id. at 394. Similarly, in Fleming v. Citizens for Albermarle, 577 F.2d 236 (4th Cir. 1978), cert. denied 439 U.S. 1071 (1979), this Court's reversal, for abuse of discretion, of the lower court's denial of intervention was based on the dispatch with which the intervenor-applicants made their motion relative to the point at which it became clear that their interests were not being adequately represented by the existing defendants. Here, the intervenors cite United

Airlines and Fleming for the proposition that even post-judgment intervention may be allowed. However, they do not contend that intervention at an earlier point would have served no purpose or that the tardiness of their motion was a result of prior reliance on one or more of the parties in Robinson. While last-second or even post-judgment intervention may be proper in some cases, the Weisman intervenors are unable to demonstrate that this is such a case.

The second component of the timeliness analysis, prejudice to the non-intervening parties, similarly works against the would-be intervenors. The intervention motion, if granted, would likely have required substantial additional litigation. In addition to the delay in the disbursal of the settlement funds which would have ensued had intervention been permitted, two

provisions in the "Stipulation of Settlement" would have acted to prejudice the Robinson plaintiff class if the intervenors had been permitted to litigate. First, the settlement provided for the payment of attorneys' fees from the $6,950,000 settlement fund itself. Therefore, additional litigation would have acted to eat away at the plaintiffs' share of the fund as their legal fees rose. Secondly, the stipulation provided that interest on the fund would only accrue to the plaintiffs' benefit after the court had approved the settlement. The effect of intervention, then, and the resulting delay in court approval of the settlement would have acted to effectively reduce the value of the fund. Further delay, then, clearly would have prejudiced the plaintiff class.

The third consideration guiding the court's exercise of discretion is the

reason for the tardiness of the motion. Weisman, admittedly the motivating force behalf all of the various assaults on the settlement, alleged that his illness was the reason for the last-second filing. Weisman's health problems, however, did not interfere with his ability to file, as attorney of record as well as a plaintiff, the 102-page Gould complaint (plus 1,835 pages of exhibits) on August 15, 1988, and the 155-page "First Amended Complaint" on September 2, 1988. Moreover, the August 1 objection to the settlement was filed on his behalf by attorneys from a different law firm than his co-counsel in Gould. The fact that he is a lawyer himself, with at least two law firms retained by him for this and related litigation, belies his argument that illness alone should excuse his last-second filing. Thus, under all the circumstances of this case, we cannot say

that the lower court abused its discretion in denying the motion to intervene as untimely filed.

For the foregoing reasons, we affirm the district court's denial of the motion to intervene on the alternative grounds of lack of sufficient interest (standing) as well as untimeliness. We further affirm the district court's ruling that Weisman lacked standing to object to the proposed Robinson settlement.

AFFIRMED.

# APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

LEONARD ROBINSON, et al *

v. * Civil Action

ALLEGHENY BEVERAGE CORP., et al * No. S-86-2309

* * * * * * * * * * *

The above-entitled matter came on for hearing before the Honorable Frederic Smalkin, commencing at 11:15 a.m. on September 6th, 1988, at Baltimore, Maryland.

## A P P E A R A N C E S

On behalf of the Plaintiffs:

Steven A. Allen, Esquire
Bruce K. Cohen, Esquire
Lawrence Lederman, Esquire

On behalf of the Defendant Lapides and Alleco, Inc.:

A. Raymond Randolph, Esquire

On behalf of the Plaintiffs Weisman, Marks, Inc., and Day:

Paul Sandler, Esquire
David Freishtat, Esquire
Dolph Schmidt, Esquire

On behalf of Defendant Allegheny Beverage Corporation:

Mark Garfinkle, Esquire
Leslie A. Blackmon, Esquire
Stephen A. Glickman, Esquire

JULIE TRIMMELL BILLUPS, OFFICAL REPORTER

THE COURT: I don't think he meant to bring down Rule 11 on you and I don't take his remarks as doing that.

All right. Motion for intervention and delay of settlement is denied. The reasons are as follows:

First, I find that Rule 24 does not give standing to any of the parties that are seeking to intervene, that is Weisman, Marks and Day, standing to intervene as a matter of right. I find that to say that a shareholder who is not a member of the class or a general creditor or trade creditor or a holder of a debt instrument can intervene with regard to the fairness hearing portion of a class action settlement is not an appropriate construction of Rule 24. I don't think it allows any such thing.

Obviously, anybody who has any interest at all in the financial health

of the corporation has some kind of interest in what its bottom line is. It is going to be affected by any one of a number of things, including settlements of litigation, and I think the policy towards an amicable resolution of litigation strongly outweighs the right of somebody to come in and say well, in the future my stake in the corporation might be diminished because they might have less cash than if the conclusion, which is that if the case went to trial the corporation might be hit for millions and millions and hundreds of millions of dollars in damages and be devastated, including punitive damages which would not necessarily be covered by insurance; so I think that the reed on which intervention as a matter of right is sought under Rule 24 is far too thin to support it under any recognized interpretation of the rule as I see it.

Now, going even further, the intervention has to be timely. I can't think of anything that is more untimely than coming in on the morning of a hearing that has been set for months and months, as to which there has been public notice given by publication and private notice given otherwise, and coming in on the morning of that when a vast class of stockholders is affected and filing a motion for intervention and for delay of a proceeding that has been set and advertised for some period of time, without any strong showing either of likelihood of any success in bringing about disapproval of the proposed settlement or of any recognized harm that the law will protect being invaded by the proposed settlement.

This is utterly untimely. Mr. Weisman has been sick. That is true. Everybody realizes he's been sick since

July sometime. However, these proceedings have been scheduled for a long period of time. His local counsel, Mr. Sandler, certainly has known about it; but that's not to say Mr. Weisman personally knew, but he certainly knew something was going on.

It is clear to me from reading all of the motions and papers and letters and other things that Mr. Weisman has filed that he is aware and well aware of Mr. Lapides' and Alleco's activities for months, and that Mr. Weisman has conveyed not only in the things he has filed with this Court but in the letters and other indications that he's been upset with what Mr. Lapides and the corporation have been doing for some period of time.

If you read the material he has submitted to the Court, there is a lot of ad hominem excoriation in it, which indicates to me he has some personal

grudge against Lapides and he sees the corporation as an alter ego of Lapides, but there is certainly nothing there that in my judgment is enough to give an intervention as a matter of right under the rule, especially with regard to timeliness. He said he's been sick but he found the time to file these numerous pleadings and other things at the very last minute. He had counsel file an objection, although it was out of time. It was filed several weeks ago, maybe even a month ago. I forgot exactly when the objection came in, and there has been plenty of time to do things in the orderly course; therefore, the attempt to intervene literally at the last minute is clearly untimely and will not be tolerated.

Further, turning to the merits of the proposed intervention the Court finds that under settled law, and I must say,

Mr. Freishtat and Mr. Sandler, you are recognized as competent attorneys certainly by the Courts in this jurisdiction, including this Court, and I would put it to you that if there is a contrary authority to that cited by the people who oppose intervention, it could have easily been found through Shepardizing the one bellwether case or otherwise in 15 minutes or half an hour of concentrated legal research.

I think there just is no contrary authority because it is plain as the nose on the Sphinx's face used to be, anyway, that the class action by shareholders is susceptible to only one class of shareholders at a time, and if there is a class action, and this case has been certified as a class action, we can't have a competing bunch of people who claim to be members of the same class coming in and seeking to represent the

class in a position that is antithetical to that that has been worked out by the attorneys duly representing the class. In other words, first in time gets to represent the class.

Mr. Weisman is coming in at the last minute. He came in and filed the suit purporting to represent a class of stockholders that is already here represented and litigating, and if you look at paragraph 23 of the Amended Complaint you will see that the class that is purported of shareholders at least in the Amended Complaint in the Gould case, and I am talking about S-88-2399, tracks precisely the class that is settling in Robinson, and if you were to just say any attorney who comes in can represent a class that is already represented by some other attorney, you put the entire process of class actions, let alone settlement of class actions,

into chaos from which it could not be rescued by any rational process.

Now, turning to Mr. Weisman, who purports to want to intervene as a bondholder, he's not a shareholder, as a bondholder, I would find that both as to his objection, which is -- do you have a docket number of that objection, Ron? It should be toward the end of the docket. See if you can pull up the original for me.

(Pause for document examination.)

THE COURT: It should have been docketed in 86-2309 towards the very end of the docket.

Anyway, he clearly in my judgment has no standing to intervene or to object to the settlement in his capacity as debenture holder. The authority is clear on this. The lead authority that we could find is Kusner, K-U-S-N-E-R, versus First Pennsylvania Corp., 74 F.R.D. 606-

610, Eastern District of Pennsylvania, 1977, affirmed 577 F2d. 726, 3rd Circuit, 1978, in which the Court said, among other things, that the explicit language of Rule 23(d)(2) limits intervention to members of the class. I think that is pretty clear, and to that extent the specific rule I should think would govern over the general rule of Rule 24.

In any event, the Court said that in Kusner and then said that obviously the holder of not just debentures but generically the holder of a instrument of a different nature or category than that held by the settlement class simply has no standing under Rule 23 and if you were to allow intervention under a different head, such as Rule 24, it would just frustrate the purposes of the specific language of Rule 23(d)(2) and also would be clearly contrary to common sense and orderly procedure.

So what you would basically be doing is to allow anybody to come in and say I don't like this settlement because it frustrates the ability of the corporation to pay its other debts, and this is not the policy that the law should adopt in this area, in my judgment anyway, and I will not tolerate it even if all this had been timely.

I also note that the objection filed by Mr. Weisman, although it was more timely than this, it nevertheless in the overall scheme of things in my judgment, still untimely.

As I said, he's been sick but he has still been functioning, and he's been functional sufficiently to come in with this last minute flurry of stuff. I see no reason in law or equity to grant the motion for intervention or to delay settlement or to allow him to object to the proposed settlement. Therefore, I am

endorsing the motion for intervention with a marginal order, motion denied for reasons stated in open court this date.

This is the 6th. Hand me up paper number 41, Mr. Clerk.

(Discussion held off the record.)

THE COURT: In the meantime, I am going to endorse a marginal on number 41 also.

There are many other reasons obviously that could be assigned in support of the Court's ruling, but I think I have stated an adequate basis for it. There are many other cases that would support it and I don't think any useful purpose would be served in going on at any great length.

# APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

| | |
|---|---|
| ALLECO, INC. | **JUDGMENT IN A CIVIL CASE** |
| v. | |
| **IBJ SCHRODER BANK & TRUST COMPANY, et al** | **CASE NUMBER: Civil 3-87-802** |

**Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED

1. The motion of Alleco, Inc., LP Acquisition Corporation, and Lapides Corporation for summary judgment is **DENIED**;

2. The motion of IBJ Schroder Bank & Trust Company for summary judgment is **GRANTED**, as follows:

a. Judgment is entered in favor of Schroder and against Alleco, Service America, Lapides and LP,

dismissing with prejudice the original Complaint and the First Amended and Supplemental Complaint in this matter,

b. Further, judgment is entered in favor of Schroder on its First Counterclaim and against Alleco, Service America, Lapides and LP, declaring that Alleco is not released from liability for the payment of principal and interest on Alleco's 9-1/2% Convertible Senior Subordinated Debentures Due 2010 in the principal amount of $105 million, and

c. Further, judgment is entered in favor of Schroder on its Third Counterclaim and against Alleco, Service America, Lapides and LP, declaring that LP's acquisition on September 14,

1988 of Alleco's publicly-held common stock through a tender offer by LP, the merger of Alleco with and into LP on October 18, 1988, and the dissolution of the surviving corporation and the distribution of its assets to Lapides on November 8, 1988, constituted a repudiation of Alleco's obligations under the Debentures and under the Indenture, dated as of September 1, 1985, between Alleco and the original trustee, First Trust Company, Inc., and a breach of the covenants contained in Section 5.05 of the Indenture, giving rise to an Event of Default under the Indenture and permitting Schroder properly to give written notice of default and to

declare the principal of all the Debentures and the interest accrued thereon to be immediately due and payable.

3. The motion of Service America Corporation for summary judgment is **DENIED** with respect to the counterclaims of IBJ Schroder Bank & Trust Company, and **GRANTED** with respect to the counterclaims of Salomon Brothers, Inc., and Salomon's counterclaims are **DISMISSED**; and

4. The second and fourth counterclaims of Schroder's First Amended and Supplemental Complaint and Counterclaims are dismissed without prejudice pursuant to Fed. R. Civ. P. 41(a)(2).

Date:
Aug. 16, 1989

FRANCIS E. DOSAL,
CLERK

/S/ Patricia J. Sabin
(by) Patricia J. Sabin,
Deputy Clerk

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

Alleco, Inc.,

Plaintiff,

v.

IBJ Schroder Bank & Trust Company, as Successor Trustee,

Defendant,

and

Salomon Brothers, Inc.,

Intervenor.

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Salomon Brothers, Inc.,

Intervenor/
Counterclaim
Plaintiff,

v.

Alleco, Inc. and Service America Corporation,

Counterclaim
Defendants.

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Civil File No.
3-87-0802

**MEMORANDUM AND ORDER**

IBJ Schroder Bank & Trust Company,

Defendant/
Counterclaim
Plaintiff,

v.

Alleco, Inc., et al

Counterclaim
Defendants.

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George M. von Mehren, Esq., Squire, Sanders & Dempsey, 1800 Huntington Building, Cleveland, OH 44115; E. Timothy McAuliffe, Esq., Coudert Brothers, 1627 I Street NW, Washington, DC 20006; R. Walter Bachman, Esq., Lindquist & Vennum, 4200 IDS Center, 80 South Eighth Street, Minneapolis, MN 55402; and Richard A. Kaplan, Esq., Popham, Haik, Schnobrich & Kaufman, Ltd., 3300 Piper Jaffray Tower, 222 South Ninth Street, Minneapolis, MN 55402, on behalf of Alleco, Inc., Lapides Corporation, and LP Acquisition Corp.

James B. Loken, Esq., Faegre & Benson, 2200 Norwest Center, 90 South Seventh St., Minneapolis, MN 55402; and Arthur S. Linker, Esq., Roseman & Colin, 575 Madison Ave., New York, NY 10022, on behalf of IBJ Schroder Bank & Trust Company.

Christine B. Pendry, Esq., Davis, Polk & Wardwell, One Chase Manhattan Plaza, New York, NY 10005; and Charles Quaintance, Jr., Esq., Maslon, Edelman, Borman & Brand, 1800 Midwest Plaza, Minneapolis,

MN 55402, on behalf of Service America Corporation.

Timothy D. Kelly, Esq., Kelly & Berens, P.A., 3720 IDS Center, 80 South Eighth St., Minneapolis, MN 55402, on behalf of Fidelity Management and Resource Company, amicus curiae.

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In September 1985, Allegheny Beverage Corporation issued $105 million in 9-1/2% Convertible Senior Subordinated Debentures Due 2010. This dispute focuses on the interpretation of the Debenture Certificates and the accompanying Indenture. Within three years after these Debentures\1 were issued, the company changed its name to Alleco, Inc., sold off its operating subsidiaries, and dissolved.

Alleco sold its final subsidiary,

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\1 Alleco has issued other debentures which are not relevant to this proceeding. Hereinafter, any reference to the term Debenture with an upper case "D" refers to Alleco's 9-1/2% convertible debentures due 2010.

Service America Corporation, via a leveraged buy-out in December 1987. Service America, now a wholly-owned subsidiary of Servam Corporation, assumed the payment obligations on the Debentures. One of the issues before this court is whether Alleco has been released from its payment obligation by Service America's assumption and subsequent events.

Service America did not assume the Debentures' conversion obligation. This remained with Alleco. Alleco's controlling shareholder, Martin Lapides, commenced a tender offer for Alleco common stock in July 1988. This tender offer, accomplished through LP Acquisition Corporation, resulted in the merger of Alleco and LP Acquisition on October 18, 1988. A supplemental indenture provided, pursuant to section 15.06 of the original Indenture, that all

Debenture holders retained the right to receive $465 for each $1,000 in Debenture principal in lieu of the right to convert to the now extinct Alleco common stock.

Lapides dissolved Alleco on November 8, 1988. He assumed Alleco's assets and liabilities. However, he did not assume any obligations under the Debentures and Indenture. The other two issues before the court are whether the tender offer, merger and dissolution violated the antidilution provisions of the Indenture, and whether the dissolution released Alleco from the conversion obligation.

The court finds, for the reasons stated below, that Alleco remains liable for the payment and conversion obligations of the Debentures, and that the LP tender offer violated an explicit covenant of the Indenture. Therefore, Alleco's motion for summary judgment is denied, the motion of IBJ Schroder Bank

& Trust Company for summary judgment is granted, and Service America's motion for summary judgment is denied as to Schroder's counterclaims, and granted as to the counterclaims of Salomon Brothers, Inc.

Procedural background

Alleco commenced this action on November 30, 1987 against the original trustee, First Trust Company. Alleco seeks a declaration that it was released from the payment obligation when Service America assumed that obligation.

Salomon Brothers, Inc., which owns $18,575,000 principal amount of the Debentures, obtained permission to intervene, and filed a counterclaim seeking, inter alia, a declaration that Alleco remains liable for the payment obligation, and that Alleco is in default by the terms of the Indenture.

In May 1988, IBJ Schroder Bank &

Trust Company succeeded First Trust as trustee, and was also substituted as the defendant in this action. Schroder filed a counterclaim seeking a declaration that Alleco has not been released from its payment obligation.

The Lapides-sponsored tender offer for Alleco stock was announced on July 13, 1988. Shortly thereafter, Schroder notified Alleco that it believed that the proposed tender offer, merger, and dissolution would constitute a breach of Alleco's obligations under the Indenture. In response, Alleco filed an amended and supplemental complaint seeking, inter alia, a declaration that the proposed transactions would not violate the Indenture, and that the surviving corporation would be released from all obligations under the Debentures and Indenture.

Following this court's denial of

Schroder's motion to preliminarily enjoin the Alleco tender offer, Schroder filed an amended answer and counterclaim which essentially mirrors the additional declaratory relief sought by Alleco in its supplemental complaint.

Now before the court are cross-motions for summary judgment. Alleco, with its affiliated companies, LP Acquisition Corporation and Lapides Corporation [hereinafter collectively referred to as Alleco] seek a declaration from this court that the various transactions noted above conformed with the terms of the Debentures and Indenture, as supplemented.

Schroder seeks summary judgment on its claims that Alleco remains obligated to honor both the payment and conversion obligations of the Debentures, and that the merger and dissolution constitute events of default as that term is defined

by the Indenture, as supplemented.

Schroder seeks summary judgment on its claims that Alleco remains obligated to honor both the payment and conversion obligations of the Debentures, and that the merger and dissolution constitute events of default as that term is defined by the Indenture. Salomon joins in this motion.

Service America, a counterclaim defendant, seeks summary judgment against the claims of Schroder and Salomon.

**FACTS**

Prior to 1981, Alleco was solely a beverage company. Between 1981 and 1985, the company acquired businesses in food service, laundry service, building maintenance, and retail office furniture. In May 1985 it sold its beverage operations and acquired Servomation Corporation. Alleco's smaller food service operations were consolidated with

Servomation to form Service America.

The Debentures were issued in September 1985. Between December 1986 and July 1987, Alleco sold its building maintenance, laundry service, and retail office furniture subsidiaries for $86.5 million. The proceeds were used principally to pay down bank debt. Alleco paid no dividend and made no distributions to shareholders following these sales.

In May 1987, Alleco entered into a stock purchase agreement for the sale of its Service America subsidiary. The purchasing entity, SAC Acquiring Corporation, was a wholly-owned subsidiary of Servam Corporation, which was owned by certain senior management of Service America and other investors.

In order to facilitate this sale, Alleco commenced a tender offer for the redemption of the Debentures, including

a five percent premium. This offer fell apart following the October 1987 stock market crash. Alleco and Servam then arranged for Service America to assume the Debentures.

The sale of Service America took place on December 2, 1987. By means of a leveraged buyout, SAC paid $345 million in cash, and took over payments on the $105 million in Debentures. Along with that sale, Alleco, SAC, and First Trust executed a First Supplemental Indenture which provided that SAC would assume the payment obligation. By terms of the Second Supplemental Indenture, executed the same day, this duty was assumed by Service America. Responsibility for the Debenture's convertibility remained with Alleco.

Alleco believed that the terms of the original Indenture entitled Alleco to a release from any payment obligation

once Service America assumed that duty. Accordingly, Alleco wanted the First Supplemental Indenture to provide for that release. First Trust did not agree with Alleco's interpretation of the Indenture, and refused to execute a supplemental indenture which explicitly released Alleco.

The First Supplemental Indenture left unresolved the issue of Alleco's release. Alleco filed this action in order to obtain a declaration that it had bene released.

Following the Service America sale, Alleco had approximately $130 million in cash which it intended to commit to other lines of business. Morton Lapides, Alleco's chairman of the board and chief executive officer held 21.6% of Alleco's equity through a family holding company, Lapides Corporation. Lapides also controlled a special class of stock which

allowed him to elect a majority of Alleco's board. In May 1988, Lapides began to pursue a plan for the purchase of the Alleco common stock not held by Lapides. This resulted in the July 1988 tender offer by LP Acquisition Corporation, a Lapides subsidiary, for Alleco common stock at $10 per share.

The offering document for the tender outlined the planned merger of Alleco and LP, and the eventual dissolution of Alleco and distribution of its assets to Lapides. This "Offer to Purchase states:

> In connection with such dissolution, the assets and liabilities of [Alleco] would be assumed by Lapides, and Lapides would continue to operate the business of [Alleco]. Lapides also intends to assume all of the Company's obligations under the indentures covering its outstanding subordinated indebtedness (other than the Convertible Debentures) and to pay such indebtedness...in accordance with the terms of

the indentures.

Linker aff., Ex. R at 14.

LP purchased the outstanding Alleco common stock for $67.5 million. Lapides contributed $2.5 million, and LP obtained a $65 million bridge loan from two banks. On October 18, 1988, LP and Alleco merged via a statutory short form merger. The bridge loan was then repaid using Alleco's own funds.

That same day, Alleco, Service America and Schroder, as successor trustee, executed a Third Supplemental Indenture. This supplement provided that the Debentures would be convertible into cash pursuant to the formula established in Article Fifteen of the original Indenture. In other words, the right to convert to Alleco stock became the right to exchange each $1,000 in Debenture principal for $465 in cash. The Third Supplemental Indenture also reiterated

that "the holder of any Debenture shall have the right, at his option, at any time prior to the close of business on September 1, 2010..." to make the conversion to cash, subject only to the Company's right to redeem the Debentures. Lapides aff., Ex., 18 at 7-8. The surviving corporation, which changed its name to Alleco, Inc. retained the responsibility to honor the conversion rights.

On October 21, Lapides notified all Debenture holders that Alleco would be voluntarily dissolved. Following dissolution, Lapides disclaimed any responsibility for the Debentures. All interest installments have been paid when due by Service America. Lapides takes the position that the conversion right expired shortly after Alleco dissolved.

**ANALYSIS**

The court's jurisdiction over this

matter is based on 28 U.S.C. Section 1332, and venue is proper in this district.

As is often the case in a declaratory judgment action, the facts giving rise to this cause of action are not in dispute. The dispute concerns the application of the parties' contract--the Debentures and the Indenture--to the transactions described above.

The Eighth Circuit observed in Trnka v. Elanco Products Co., 709 F.2d 1223, 1227 (8th Cir. 1983), that "disputes involving the interpretation of unambiguous contracts are appropriate cases for the entry of summary judgment." This is particularly true when the interpretation of a standardized document like an indenture is involved. Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 f.2D 1039, 1048 (2D cIR. 1982), CERT. DENIED, 460 u.s. 1012 (1983). The

parties do not contend, and the court does not find, that the contract is ambiguous. Its interpretation is quite properly a matter of law. Id.

The term "debenture" refers to a long-term unsecured debt security, issued pursuant to an indenture, and with an indenture trustee. The relationship between the issuer (debtor) and the debenture holders (lenders) is a matter of contract. The obligation to repay the debt runs directly from the issuer to the holders, and the other rights conferred by the indenture run from the issuer to the trustee for the benefit of the holders. Broad v. Rockwell Int'l Corp., 642 F.2d 929, 941-42 (5th Cir. April 1981), cert. denied, 454 U.S. 965 (1981).

Convertible debentures, while primarily debt securities, contain an equity option. The conversion right is separate and distinct from the debt, and

has its own ascertainable value. Id. at 942 (quoting American Bar Found., Commentaries on Indentures 522-23).

Before the court are three issues concerning Alleco's relationship with its Indenture Trustee and with its Debenture holders: first, whether Alleco has been released from its obligation to make payments on the Debentures; second, whether the LP tender offer and subsequent dissolution breached the terms of the Indenture; and third, whether the conversion feature of the Debentures has been extinguished.

I. Payment obligation

Alleco contends that it was discharged from its payment obligation when Service America became the successor obligor under the First and Second Supplemental Indentures. Alternatively, Alleco argues that it was released upon its dissolution pursuant to section 12.02

of the Indenture.

Schroder responds that the original trustee, First Trust, never agreed to a novation, and therefore Alleco was not released from its payment obligation. Further Schroder contends that Alleco has not been released from this obligation because the Debenture certificates make no provision for Alleco's substitution or release.

It is elementary contract law that substitution and release are separate events. Substitution does not discharge the obligor. Without a novation the obligee retains all rights against the obligor.

> [O]ne who is bound to any performance whatever...cannot by any act of his own, or by any act in agreement with any other person than...the one to whom his performance is due, cast off his own liability and substitute another's liability. If this were not true, obligors could free themselves of their obligations by the simple

> expedient of assigning them.... [T]he performance of the third party is the act of the promisor, who remains liable under the contract and answerable in damages if the performance be not in strict fulfillment of the contract.

Crane Ice Cream Co. v. Terminal Freezing & Heating Co., 147 Md. 588, 128 A. 280, 283 (1925).

The Debenture holders and the Trustee entered into this contract in reliance on Alleco's promise to perform its obligations. Because there is no authority in the law of contract for Alleco's unilateral release from these obligations, Alleco's only grounds for release is the terms of the contract.

Article Twelve of the Indenture provides for the sale or merger of Alleco. Specifically, section 12.01 states that "nothing contained in this Indenture or in any of the Debentures...shall prevent any sale,

conveyance or lease...of all or substantially all of the property\2 of the Company, to any other corporation...." This allowance for corporate flexibility, however, is conditioned on the proviso that:

> The Company hereby covenants and agrees, that upon any such consolidation, sale, merger, conveyance or lease, the due and punctual payment of the principal of and premium, if any, and interest on all of the Debentures, according to their tenor and the due and punctual performance and observance of all of the Covenants and Conditions of this Indenture to be performed by the Company,

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\2 Whether the sale of Service America represented "substantially all" of Alleco's property is a matter vigorously disputed by the parties. However, this issue does not create a material factual dispute because its resolution is irrelevant to the outcome of the case. For purposes of this motion, the court accepts Alleco's contention that the sale of Service America constituted the sale of substantially all of Alleco's assets.

Indenture (Lapides aff. Ex. 1), Section 12.01 at 83.

> shall be elxpressly assumed, by supplemental indenture satisfactory in form to the Trustee...by the corporation which shall have acquired or leased such property.

In other words, Alleco agreed that any successor corporation would assume all covenants and conditions of the Indenture, and that the form of the assumption must be acceptable to the Trustee. Section 12.01 does nct mention release. Indeed, there is nothing in the Indenture which would require the Trustee to release Alleco following that sale. Alleco could not negotiate a release from First Trust, and since First Trust's refusal is not inconsistent with the terms of the Indenture, this court has absolutely no grounds for imposing a novation.

Alleco argues, alternatively, that it was released from the payment obligation upon its dissolution, as

allowed under section 12.02 of the Indenture.\3 This section requires the successor to assume all of Alleco's

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\3 Section 12.02 of the Indenture provides in relevant part: Successor Corporation to Be Substituted. In case of any such consolidation, merger, sale, conveyance or lease and upon the assumption by the successor corporation, by supplemental indenture, executed and delivered to the Trustee and satisfactory in form to the Trustee, of the due and punctual payment of the principal of a premium, if any, and interest on all of the Debentures and the due and punctual performance of all of the covenants and conditions of this Indenture to be performed by the Company, such successor corporation shall succeed to and be substituted for the Company, with the same effect as if it had been named herein as the party of the first part...

In the event of any such consolidation, merger, sale, conveyance or lease, the person named as the "Company" in the first paragraph of this Indenture or any successor which shall thereafter have become such in the manner prescribed in this Article Twelve may be dissolved, wound up and liquidated at any time thereafter and such person shall be released from its liabilities as obligor and maker of the Debentures and from its obligations under this Indenture.

Lapides aff. Ex. 1 at 84.

obligations for these Debentures, and then allows Alleco to be released from these obligations upon its dissolution. The only provision for the release of Alleco from its obligations for these Debentures is found in this section.

Following the sale of Service America, Alleco remained liable to the Debenture holders for any failure of Service America to make payments. Further, Alleco explicitly covenanted in the First Supplemental Indenture to honor the conversion obligation of the Debentures. Lapides aff., Ex. 6, Section 3 at 6. That is, the Debentures continued to be convertible to Alleco common stock per the agreed formula. Alleco also explicitly covenanted in the First Supplemental Indenture to continue to be bound by Section 5.05 of the Indenture. Id. Section 4(d) at 12. Section 5.05 prohibits Alleco from, inter

alia, redeeming any shares of its capital stock unless certain financial criteria were first satisfied.

The court finds, based on the language of section 12.02 that a condition precedent to Alleco's release was the assumption by Service America of all covenants and conditions of the Indenture. The section requires the execution of a supplemental indenture by which a successor corporation assumes the due and punctual payment of principal, premium, if any, and interest, "and the due and punctual performance of all the covenants and conditions of this Indenture to be performed by the Company...." The section then allows for a release upon dissolution. There is no provision for a partial release.

As noted above, Service America did not assume certain major obligations. Not having met the requirement that the

successor assume all obligations, there is no reason to consider what follows -- release. This section, and sections like it, provide issuers with flexibility. In return, such sections assure the holders that the issuer will provide for its covenants. This dispute is a case in point. Alleco arranged for Service America to make payments, but made no provision for its conversion obligation. In fact, Alleco repudiated that obligation. This is precisely the type of misconduct against which section 12.02 was intended to protect.

In conclusion, because Alleco failed to provide a successor to assume all of its obligations, it is not entitled to a release of any of its obligations. Alleco remains accountable for the due and punctual payment of the principal, premium, if any, and interest on the Debentures.

Schroder contends that Alleco cannot be released from the payment obligation because the Debenture certificates make no provision for Alleco's release. Alleco responds that the Debentures require "the Company" to make payments, and that Article Twelve of the Indenture defines the conditions under which a successor may become "the Company."

Alleco does not dispute that the Debentures fail to provide the holders with any notice of Alleco's potential release or the circumstances under which such release may be obtained. In fact, each Debenture states:

> No reference herein to the Indenture and no provision of this Debenture or of the Indenture shall alter or impair the obligation of the Company, which is absolute and unconditional, to pay the principal of any premium and interest on this Debenture at the place, at the respective times, at the rate and in the coin or currency herein prescribed.

Lapides aff. Ex. 1 at 5.

Further, the Debentures provide only one definition of "Company":

> **ALLEGHENY BEVERAGE CORPORATION**, a corporation duly organized and existing under the laws of the State of Maryland (herein called the "Company")....

Id. at 1. The document gives no notice that a party other than Alleco may take over the duties of the obligor.

These Debentures are a "certificated security" under section 8-102(1)(a) of the Maryland Commercial Code. Section 8-202(1)(c) allows such a security to incorporate the terms of an indenture by reference, but only "to the extent that the terms referred to do not conflict with the terms stated on the certificated security...." Here, the Indenture's provisions for substitution and release are, by omission, inconsistent with the

terms of the Debenture.\4 In sum, regardless of the above interpretation of Article Twelve of the Indenture, any claim of release is ineffective because of Alleco's failure to disclose this possibility on the face of the Debentures.

II. Tender Offer and Merger

Pursuant to a successful tender

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\4 The comments accompanying the American Bar Association's Model Simplified Indenture are consistent with the commercial code. The model indenture's section on mergers, consolidations or sales does not provide for the release of the original issuer. According to the comments:

> Issuers objecting to such continuing liability, or concerned that such liability may make it difficult to liquidate (or to proceed as an investment company) following a sale of assets, should change the last paragraph of this Section and consider appropriate summary disclosure in the form of Security.

Model Simplified Indenture, Section 5.01 comment 6, 38 Bus. Law. 741, 791 (1982) (emphasis added).

offer, LP Acquisition Corporation purchased the outstanding shares of Alleco common stock for $67.5 million. The two companies merged, and the new company was named Alleco, Inc. The following day, Alleco repaid a bridge loan of $65 million taken out by LP to finance the purchase of Alleco common stock. There is no dispute that the funds used to repay this loan were assets of the former Alleco, Inc. prior to the merger.

Schroder contends that this series of transactions violated section 5.05(a) of the Indenture\5. This section allows

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\5 Section 5.05(a) provides:

> Restrictions on Dividends and Redemption of Capital Stock. No dividend whatever shall be declared or paid not shall any distribution be made on any capital stock of the Company (except in shares of capital stock of the Company), nor shall any shares of capital

Alleco to pay dividends or make distributions to shareholders, or to redeem its capital stock only if the companay can first satisfy certain financial requirements.

Alleco does not contend that it satissfied the requirements of section 5.05 at the time of the tender offer. It contends that the section does not apply

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stock of the Company be acquired or redeemed by the Company or any Subsidiary, unless after giving effect to such dividend, distribution, acquisition or redemption, the aggregate payments for all such purposes subsequent to June 30, 1985 would not exceed the sum of (A) 50% of the Net Income of the Company (determined on a cumulative basis) for the period commencing July 1, 1985 and ending on the last day of the immediately preceding calendar month (or in the event that such Net Income (determined on a cumulative basis) is a negative amount, 100% of such Net Income); (B) the aggregate of the net proceed received by the Company from the sale for cash or other

because LP, not Alleco, purchased Alleco's common stock. In essence, Alleco asks the court to ignore the substance of these transactions, and look only at their form.

Such sections are common. They protect debenture holders from the dissipation of corporate assets to shareholders, thus maintaining the

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> property (including issuance in any merger, consolidation or similar transaction) or shares of its capital stock subsequent to September 1, 1985; (C) the aggregate of the net proceeds received by the Company from the issuance of the Debentures or the issuance of sale of any other debt obligation of the Company, which Debentures or debt obligation shall have been converted into shares of Common Stock of the Company after September 1, 1985; and (D) $12,000,000.00

Lapides aff. Ex. 1 at 40. As noted previously, Alleco reaffirmed its obligations under this section in the First Supplemental Indenture, Section 4(d).

capacity of the issuer to make payments and preventing the issuer from diluting the value of a conversion feature. If the court were to accept Alleco's argument, then sections like 5.05 would provide little or no protection for debenture holders. According to Alleco, establishing a shell corporation is all that is necessary to sidestep an obligor's promise to maintain its assets.

LP's tender was in effect a self-tender. Alleco cash was used to purchase Alleco shares. As a result of these transactions, Alleco's primary shareholder received a huge distribution of Alleco assets. This is precisely the result intended by Lapides when he initiated the tender offer, and this is precisely the conduct which section 5.05 prohibits.

If sections like 5.05 are to have any meaning, courts must consider the

substance of the disputed transaction. "[W]hat cannot be legally done in one act does not necessarily become legal when the act is split up into various steps, all seeking and attempting to do in final result, what the one act might have accomplished." In re Associated Gas & Elec. Co., 61 F. Supp. 11, 28 (S.D. N.Y. 1944) (issuer violated indenture by executing many partial sales of assets in derogation of covenant to not sell substantially all of its assets), aff'd, 149 F.2d 996 (2d. Cir.), cert. denied sub nom., 326 U.S. 736 (1945). See also Mayor of Baltimore v. Bio Gro Systems, Inc., 300 Md. 248, 477 A.2d 783, 787 (1984) (city cannot do indirectly what it is prohibited from doing directly).

In sum, the tender offer and merger violated the terms of section 5.05.

Under section 7.01(d)\6 of the Indenture,

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\6 Section 7.01 of the Indenture provides in relevant part:

Events of Default. In case one or more of the following Events of Default...shall have occurred and be continuing:

...

> (d) failure on the part of the Company duly to observe or perform any other of the covenants or agreements on the part of the Company in the Debentures or in this Indenture continued fora period of sixty days after the date on which written notice of such failure, requiring the Company to remedy the same, shall have been given to the Company by the Trustee, or to the Company and the Trustee by the holders of at least twenty-five percent in aggregate principal amount of the Debentures at the time outstanding;

...

then and in each and every such case, unless the principal of all of the Debentures shall have already become due and payable, either the Trustee or the holders of not less than twenty-five percent in aggregate principal amount of the Debentures then outstanding hereunder, by notice in writing to the company (and to the Trustee if given by

Alleco's failure to honor section 5.05 constitutes an event of default.

III. Conversion Obligation

The Third Supplemental Indenture, executed on October 18, 1988 following the merger of LP and Alleco, provides that "each Debenture shall be convertible into, and only into, cash in the manner provided in Article Fifteen of the Amended Original Indenture, as amended and supplemented by this Third Supplemental Indenture." Lapides aff., Ex. 18 at 7. Section 15.06 of the original Indenture provides for the

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> Debentureholders), may declare the principal of all the Debentures and t he interest accrued thereon to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable, anything in this Indenture or in the Debentures contained to t h e c o n t r a r y notwithstanding....
>
> Lapides aff., Ex. 1 at 46-47.

convertibility of the Debentures in the event of a merger or similar transaction. It requires the successor coporation to execute a supplemental indenture "providing that each Debenture shall be convertible into the kind and amount of shares of stock and other securities or property or assets (including cash)..." which the holder would have received had he converted such Debentures immediately prior to the merger. Lapides aff., Ex. 1 at 93-94.

LP offered $10 cash for each share of Alleco common stock, and the Debentures are convertible to 46.5 shares of Alleco common stock. Therefore, the Third Supplemental Indenture transformed the conversion feature into the right to receive $465 cash for each $1,000 in Debenture principal. This supplement also reaffirmed section 15.01 of the Indenture concerning each Debenture

holder's right to convert at any time prior to the close of business on September 1, 2010, subject only to the company's right to redeem the Debentures prior to that date. Lapides aff., Ex. 18 at 7-8.

Alleco contends that the conversion feature was extinguished upon Alleco's dissolution. However, there is absolutely nothing in the original Indenture or the supplements which allows the company or a successor to repudiate its conversion obligation. Section 12.02 of the Indenture provides for a release upon dissolution if a successor has assumed all obligations and covenants under the Indenture. No successor assumed the conversion obligation.

Alleco argues that section 15.10 of the Indenture provides grounds for the extinguishing of its conversion obligation. However, this section is

nothing more than a notice provision. It simply allows holders to exercise their conversion rights prior to certain events, including a dissolution. It does not provide any warning to holders of the possible loss of their conversion rights upon dissolution. Lapides aff. Ex. 1 at 95-96.

A corporation cannot obtain a release from its obligations by means of a voluntary dissolution, especially when a purpose of the dissolution is the avoidance of an undesirable contract. 16A Fletcher's Cyclopedia of Corporations, Section 8120 at 375-76 (1988 rev. ed.). Such is the case here. The offering document for the LP tender revealed Lapides' intent to repudiate all obligations to these Debenture holders following Alleco's dissolution.

The Indenture explicitly provides that the right to convert is exercisable

until the year 2010. The repudiation of this right is without foundation in the parties' contract. In sum, Alleco remains liable for the convertibility of these Debentures, per its undertaking in Article Fifteen of the Indenture, as supplemented by the Third Supplemental Indenture.

IV. Other Matters

Schroder asks the court to dismiss without prejudice its second and fourth counterclaims. Its second counterclaim, seeking to enjoin the LP tender offer, merger, and dissolution, is now moot. The fourth counterclaim alleges violations of the Maryland Uniform Fraudulent Conveyances Act. Md. Com. Code Ann., Subsection 15-201 et seq.

Alleco objects, arguing that instead of dismissal the court should grant Alleco summary judgment against these counts. Alleco's argument is that since

Alleco has been released form its obligations on these Debentures, the holders are no longer creditors of Alleco. If not creditors, therefore, they can have no claim under the Act. However, since Alleco has not been released, the holders remain creditors of Alleco. Summary judgment, therefore, is not warranted.

The decision to grant a voluntary dismissal, pursuant to Fed. R. Civ. P. 41(a)(2), is a matter committed to the sound discretion of the trial court. Holmgren v. Massey-Ferguson, Inc., 516 F.2d 856, 8567 n.1 (8th Cir. 1972). Given the developments since Schroder filed its counterclaim, these two counts now encompass issues and parties beyond this litigation. The court, therefore, will grant Schroder's motion to dismiss these counts without prejudice.

Based on the stipulation of the

parties, and pursuant to Fed. R. Civ. P. 24, Salomon Brothers, Inc. was permitted to intervene as a party defendant in January 1988. Salomon filed counterclaims seeking declaratory relief similar to that sought by Schroder, seeking certification of a class, and seeking imposition of a constructive trust on Service America's assets.

Salomon filed its counterclaims prior to Schroder's appointment as successor trustee. Salomon has since indicated its satisfaction with Schroder's protection of the Debenture holder's interests. Correspondingly, Salomon has been less vigorous in its pursuit of its counterclaims.

The "no action" clause of the Indenture, section 7.04\7 restricts the rights of holders of less than twenty-

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\7 Lapides aff., Ex. 1 at 51-52.

parties, and pursuant to Fed. R. Civ. P. 24, Salomon Brothers, Inc. was permitted to intervene as a party defendant in January 1988. Salomon filed counterclaims seeking declaratory relief similar to that sought by Schroder, seeking certification of a class, and seeking imposition of a constructive trust on Service America's assets.

Salomon filed its counterclaims prior to Schroder's appointment as successor trustee. Salomon has since indicated its satisfaction with Schroder's protection of the Debenture holder's interests. Correspondingly, Salomon has been less vigorous in its pursuit of its counterclaims.

The "no action" clause of the Indenture, section 7.04\7 restricts the rights of holders of less than twenty-five percent of the aggregate principal amount of the Debentures to bring suit on

five percent of the aggregate principal amount of the Debentures to bring suit on theiir own. Salomon holds approximately 19% of the Debentures principal. Under this section, therefore, Salomon may bring suit only to enforce its right to payment or its conversion right. Accordingly, Salomon's counterclaim for class certification and constructive trust are dismissed for failure to comply with the terms of section 7.04.

Service America has made all payments when due. Salomon counts related to payment, therefore, fail to state a claim. In any event, these claims have been fully presented by Schroder as trustee. Salomon has pled no count related to the conversion right. In sum, two of Salomon's counterclaims are barred by the terms of the Indenture, and the counts on which direct action is permitted fail to state a claim.

## CONCLUSION

Though complicated by the amount in controversy, this is a relatively simple case. Alleco and its controlling shareholder have flaunted the Indenture, and have pursued these schemes with utter disregard for the rights of the Debenture holders. This conduct violated numerous terms of the Indenture. Consistent with Article Seven of the Indenture, Alleco has defaulted on its obligations to its Debenture holders.

Accordingly, **IT IS ORDERED** that:

1. The motion of Alleco, Inc., LP Acquisition Corporation, and Lapides Corporation for summary judgment is **DENIED**;

2. The motion of IBJ Schroder Bank & Trust Company for summary judgment is **GRANTED**, as follows:

a. Judgment is entered in favor of Schroder and against Alleco,

Service America, Lapides and LP, dismissing with prejudice the original Complaint and the First Amended and Supplemental Complaint in this matter,

b. Further, judgment is entered in favor of Schroder on its First Counterclaim and against Alleco, Service America, Lapides and LP, declaring that Alleco is not released from liability for the payment of principal and interest on Alleco's 9-1/2% Convertible Senior Subordinated Debentures Due 2010 in the principal amount of $105 million, and

c. Further, judgment is entered in favor of Schroder on its Third Counterclaim and against Alleco, Service America, Lapides and LP, declaring that LP's

acquisition on September 14, 1988 of Alleco's publicly-held common stock through a tender offer by LP, the merger of Alleco with and into LP on October 18, 1988, and the dissolution of the surviving corporation and the distribution of its assets to Lapides on November 8, 1988, constituted a repudiation of Alleco's obligations under the Debentures and under the Indenture, dated as of September 1, 1985, between Alleco and the original trustee, First Trust Company, Inc., and a breach of the covenants contained in Section 5.05 of the Indenture, giving rise to an Event of Default under the Indenture and permitting Schroder properly to give

written notice of default and to declare the principal of all the Debentures and the interest accrued thereon to be immediately due and payable.

3. The motion of Service America Corporation for summary judgment is **DENIED** with respect to the counteclaims of IBJ Schroder Bank & Trust Company, and **GRANTED** with respect to the counterclaims of Salomon Brothers, Inc., and Salomon's counterclaims are **DISMISSED**; and

4. The second and fourth counterclaims of Schroder's First Amended and Supplemental Complaint and Counterclaims are dismissed without prejudice pursuant to Fed. R. Civ. P. 41(a)(2).

**LET JUDGMENT BE ENTERED ACCORDINGLY.**

**Dated: August 16, 1989.**

/S/ PAUL A. MAGNUSON
**Paul A. Magnuson**
**United States**
**District Judge**

# APPENDIX E

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND

| | | |
|---|---|---|
| IN RE: | * | |
| ALLECO, INC. | * | Case No. |
| Debtor | * | 894 2987 |
| Debtor's Employer Tax Identification No. 52-1158079 | * | |

* * * * * * *

INVOLUNTARY CASE: CREDITORS' PETITION

1. Salomon Brothers Inc., New York City, New York; Fidelity Magellan Fund, Boston, Massachusetts; Mutual Series Fund Inc., Short Hills, New Jersey, (through its portfolio funds: Mutual Shares Fund, Mutual Qualified Fund, and Mutual Beacon Fund) are creditors of Alleco Inc. ("Alleco" or the "Debtor", which terms include the entities set forth in the caption and their predecessors in interest) of Allegheny Circle, Cheverly, Prince George's County, Maryland 20781, holding claims against the Debtor, not

contingent as to liability and not subject to bona fide dispute, amounting in the aggregate, in excess of the value of any lien held by them on the Debtor's property securing such claims, to at least $5,000.

IBJ Schroder Bank & Trust Company ("Schroder" or "Indenture Trustee") of One State Street, New York, N.Y. 10004 is the successor indenture trustee, having succeeded First Trust Company, Inc. as trustee, under an Indenture dated as of September 1, 1985 (which, together with Supplemental Indentures thereto, will be referred to herein as the "Indenture") between Allegheny Beverage Corporation (now Alleco) and First Trust Company, Inc. pertaining to the issuance of $105,000,000 of 9-1/2% Convertible Senior Subordinated Debentures Due 2010 (the "9-1/2% Debentures").

The nature and amount of

petitioners' claims are as follows:

A. Salomon Brothers Inc is the holder of $18,525,000 principal amount of the 9-1/2% Debentures. Mutual Shares Fund is the holder of $5,095,000 principal amount of the 9-1/2% Debentures. Mutual Qualified Fund is the holder of $2,200,000 principal amount of the 9-1/2% Debentures. Mutual Beacon Fund is the holder of $948,000 principal amount of the 9-1/2% Debentures.

B. As described more fully below and in the Memorandum and Order of U.S. District Court Judge Paul A. Magnuson dated August 16, 1989 (a copy of which is attached hereto as Exhibit A) issued in the case of Alleco Inc. v. IBJ Schroder Bank & Trust Company, et al., United States District Court for the District of Minnesota, Third Division, Civil

File No. 3-87-0802 (the "Declaratory Judgment Action"), Alleco has defaulted under the Indenture.

C. In May 1987, Alleco entered into an agreement to sell what was then the last of its operating subsidiaries by selling it via a leveraged buy-out to another entity for cash and the assumption of certain obligations (the "Sale Transaction"). Alleco asserted that after the Sale Transaction it would no longer be liable on its payment obligations to the holders of the 9-1/2% Debentures. Holders of the 9-1/2% Debentures advised ALleco that following the proposed Sale Transaction, Alleco would remain liable on such payment obligations. Alleco responded on November 30, 1987 by instituting the Declaratory Judgment Action. On December 2,

1987, Alleco closed the Sale Transaction.

D. On July 13, 1988, Alleco announced a series of transactions, including a certain tender offer, merger and dissolution, pursuant to which, Alleco was to pay to Alleco shareholders $65,000,000 in cash to retire substantially all of the outstanding stock (the "Repurchase Transactions") but for the stock held directly and indirectly by Alleco's Chairman, Morton Lapides. Schroder and certain holders of the 9-1/2% Debentures advised Alleco that the proposed Repurchase Transactions would violate the covenant in the Indenture restricting dividends and redemptions of capital stock, and would constitute an event of default under the Indenture. Between

September 14, 1988 and November 9, 1988, Alleco consummated the Repurchase Transactions.

E. Counterclaims and amended and supplemental complaints, responsive pleadings, and cross-motions for summary judgment were filed in the Declaratory Judgement Action, bringing squarely before the U.S. District Court the issues of (i) whether Alleco continued to be liable to the holders of the 9 1/2% Debentures after the Sale Transaction, and (ii) whether the Repurchase Transactions violated the Indenture.

F. By Memorandum and Order dated August 16, 1989, U.S. District Court Judge Paul A. Magnuson determined that Alleco and its controlling shareholder "flaunted the Indenture, and have pursued these schemes with

utter disregard for the rights of the Debenture holders". Judge Magnuson concluded that Alleco "violated numerous terms of the Indenture", and is thereby in default under the Indenture covering the 9-1/2% Debentures. (Exhibit A, pages 25-26.)

G. On September 11, 1989, Schroder issued notice to ALleco declaring the entire principal of the 9-1/2% Debentures and accrued interest thereon to be in default and to be due and payable immediately, and delivered demand for payment to Alleco. A copy of the Notice of Acceleration and Demand for Payment is attached hereto as Exhibit B. In consequence of such defaults and Notice, the entire $105,000,000 in principal under the 9-1/2% Debentures, and accrued interest

thereon, is currently due and payable.

H. The obligations currently due and payable to the petitioners as described above remain unpaid at the date of this Petition.

2. The Debtor's principal place of business has been within this district for the 180 days preceding the filing of this petition.

3. The Debtor is a person against whom an order for relief may be entered under Title 11, United States Code.

4. The Debtor is generally not paying its debts which are not subject to bona fide dispute as they become due as indicated by the following:

A. The Debtor has failed to pay $105,000,000 in principal, plus

accrued interest thereon, currently due and payable to the petitioners and the other holders of the 9-1/2% Debentures, despite demand therefor.

B. The most recent of Debtor's financial statements available to petitioners appears in Form 10-Q filed by the Debtor with the Securities and Exchange Commission dated August 11, 1989 (attached hereto is Exhibit C). It contains, inter alia, an unaudited condensed consolidated balance sheet of Alleco dated June 30, 1989 (the "Balance Sheet"), at pages 5-6 of Exhibit C; a condensed consolidated statement of operations for the nine-months ended June 30, 1989 (The "Nine-Month" Operating Statement), at pages 7-8 of Exhibit C; and a condensed consolidated statement of cash flows for the nine-months ended

June 30, 1989 (the "Nine-Month Cash Flow Statement"), at pages 9-10 of Exhibit C.

(i) The Balance Sheet reflects aggregate assets in the amount of $101,666,000, and aggregate liabilities of $92,848,000, without including among the liabilities the $105,000,000 currently due and payable under the 9-1/2% Debentures. As noted in the second paragraph of page 2 of Exhibit C (amplified under the heading "Extraordinary Items" at page 4 of Exhibit C), Alleco prepaid and retired certain debentures on July 14, 1989 (two weeks after the date of the Balance Sheet) at a cost of $24,563,000, thereby effectively reducing the current liabilities of Alleco by $24,563,000 and apparently reducing its cash by a like amount of $24,563,000. Furthermore, Note

Alleco debt in default and unpaid to the petitioners and the other holders of the 9-1/2% Debentures constitutes 70% of the outstanding debts of Alleco. It is likewise evident that Alleco's aggregate assets of $77,103,000 are substantially less than the $105,000,000 currently due and payable to the 9-1/2% Debenture holders, and that debtor's aggregate liabilities exceed its aggregate assets by over $70,000,000.

(ii) The Nine-Month Operating Statement reports a loss of $1,138,000 on aggregate revenues of $16,502,000. Of the aggregate revenues reported by Alleco, $4,102,00 is a non-recurring income tax refund, which, if not received during that nine-month period, would have increased the nine-month loss to $5,240,000.

Alleco debt in default and unpaid to the petitioners and the other holders of the 9-1/2% Debentures constitutes 70% of the outstanding debts of Alleco. It is likewise evident that Alleco's aggregate assets of $77,103,000 are substantially less than the $105,000,000 currently due and payable to the 9-1/2% Debenture holders, and that debtor's aggregate liabilities exceed its aggregate assets by over $70,000,000.

(ii) The Nine-Month Operating Statement reports a loss of $1,138,000 on aggregate revenues of $16,502,000. Of the aggregate revenues reported by Alleco, $4,102,00 is a non-recurring income tax refund, which, if not received during that nine-month period, would have increased the nine-month loss

to $5,240,000.

(iii) The Nine-Month Cash Flow Statement shows a decrease in "Cash and cash equivalents" from $194,816,000 at the beginning of the period to $35,361,000 at the end of the period. If the post-June 30, 1989 debenture prepayment ($24,563,000) described above is deducted from the June 30, 1989 figure, it is evident that the drop in "Cash and cash equivalent" is from $194,816,000 at the beginning of the period to $10,798,000 at the end.

C. As described in Paragraph 4B(i) above, Debtor has pre-paid an antecedent debt of $24,563,000 to holders of certain debentures on July 14, 1989, a payment which constitutes a preference within the meaning of 11 U.S.C. Section 547

since a petition under Title 11, United States Code has been filed within ninety days of that payment (see Exhibit C, pages 2 and 4).

D. Between September 14, 1988 and October 18, 1988, Alleco distributed to common stockholders $65,000,000 in the Repurchase Transactions (more fully described on pages 7-9 of Exhibit A), which violated the restriction against dividends and redemption of capital stock in petitioner's 9-1/2% Debenture Indenture, a transaction determined by District Judge Magnuson (Exhibit A, pages 17-20) to have violated the Indenture. The described Repurchase Transactions appear to be a series of transactions avoidable under the provisions of 11 U.S.C. Section 548.

WHEREFORE, petitioners prays that an order of relief be entered against

Alleco Inc. under chapter 7 of Title 11 of the United States Code.

/S/ NATHAN B. FEINSTEIN
Nathan B. Feinstein
Piper & Marbury
36 South Charles Street
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(301) 576-1900
Attorney for Petitioners

Of Counsel:

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# APPENDIX F

Section 2-301. "Insolvent" defined.

In this subtitle "insolvent" means that a corporation:

(1) Has debts which exceed the fair value of its assets; or

(2) Is unable to meet its debts as they mature in the ordinary course of its business. (An. Code 1957, art. 23, Sections 32, 37; 1975, ch. 311, Section 2.)

# APPENDIX G

Section 2-309. Dividends.

(a) **General rule.** - If declared by its board of directors and unless contrary to a restriction contained in its charter, a corporation may pay dividends on its shares in cash, property, or its own stock, subject to the provisions of this section.

(b) **Restrictions on declaration or payment.** - A dividend may not be declared or paid if:

(1) The corporation is insolvent or the payment would cause the corporation to become insolvent; or

(2) The corporation's stated capital is impaired or the payment would impair its stated capital.

(c) **Dividend from source other than earned surplus.** - If a dividend is paid

from any source other than earned surplus, the source of the dividend shall be disclosed not later than at the time of payment to the stockholders who receive it.

(d) **Dividend on junior class.** - Capital surplus paid with respect to a class of stock may not be used for the payment of dividends on any class of stock junior to it.

(e) **Stock dividend.** - (1) A split-up or division of issued shares into a greater number of shares of the same class without any change in the aggregate amount of stated capital is not a stock dividend within the meaning of this section.

(2)(i) If a dividend is payable in a corporation's own stock with par value, the shares shall be issued at par value and, at the time the dividend is paid, the corporation shall transfer from

surplus to stated capital an amount equal to the aggregate par value of the shares to be issued.

(ii) The corporation may transfer any additional amount from earned surplus to capital surplus as the board of directors determines.

(3)(i) If a dividend is payable in a corporation's own stock without par value, the board of directors shall adopt at the time the dividend is declared a resolution which sets the amount to be attributed to stated capital with respect to the shares and, at the time the dividend is paid, the corporation shall transfer the amount from surplus to stated capital.

(ii) The corporation may transfer any additional amount from earned surplus to capital surplus as the board of directors determines.

(iii) The amount per share of

stock transferred to stated capital and any amount transferred to capital surplus shall be disclosed not later than at the time of payment to the stockholders who receive the dividend.

(4) A dividend payable in shares of one class of a corporation's stock may not be declared or paid to the holders of shares of another class of stock unless the payment has been:

(i) Approved by the board of directors under the charter; or

(ii) Approved at a meeting of stockholders by the affirmative vote of a majority of all the votes entitled to be cast on the matter of each class entitled to vote on it.

(f) **Dividend by corporation entitled to depletion allowance.** - A corporation which is substantially engaged in the exploitation of any mine, timber, oil well, gas well, patent, or other wasting

asset, or in the development and ownership of real property, or organized substantially for the purpose of liquidating a specific asset may distribute the net income derived from the exploitation of the wasting asset or from the real property, or the net proceeds derived from the liquidation without making any deduction or allowance for the depletion of the asset or the depreciation of the real property incidental to the lapse of time, consumption, wear, liquidation, or exploitation if:

(1) Adequate provision is made for debts and liabilities, other than stated capital, and for the aggregate preferential amount payable in the event of voluntary liquidation to the holders of stock which has preferential rights; and

(2) Notice that no deduction or

allowance has been made for the depletion or depreciation is given not later than the time of payment to stockholders receiving the dividend. (An. Code 1957, art. 23, Section 37; 1975, ch. 311, Section 2; 1978, ch. 277.)

# APPENDIX H

Section 2-312. Disposition of acquired stock.

Unless its charter provides otherwise, if a corporation acquires its own stock, other than convertible shares surrendered to it or stock acquired for retirement, it may hold, sell, or otherwise dispose of the stock for any corporate purpose as determined by the board of directors. (An. Code 1957, art. 23, Section 32; 1975, ch. 311, Section 2.)

# APPENDIX I

Section 3-412. Distributions to stockholders in voluntary dissolution.

(a) **Notice to stockholders to prove interest.** - If a Maryland corporation is voluntarily dissolved and assets are available for distribution to stockholders, the director-trustees or receiver may notify the stockholders to prove their interests within a specified time at least 60 days after the date of the notice. The notice shall be mailed to each stockholders at his address as it appears on the records of the corporation and published at least once a week for three successive weeks in a newspaper of general circulation published in the county in which the principal office of the corporation is located. The date of the notice is the later of the date of

mailing or the date of first publication.

(b) **Distribution of pro rata shares.** - After the expiration of the time specified in the notice, the director-trustees or receiver may distribute to each stockholder who has proved his interest his proportionate share of the assets, reserving the shares of those who have not proved their interests. Thereafter, the director-trustees or receiver may incur reasonable expenses in locating the remaining stockholders and securing proof of interests from them and may charge the expenses against the funds undistributed at the time the expenses are incurred. From time to time the director-trustees or receiver may distribute a proportionate share to any stockholder who has proved his interest since the prior distribution.

(c) **Final distribution.** - No earlier than three years from the date of the

original notice, the director-trustees or receiver may distribute all surplus assets remaining under his control to those stockholders who have proved their interests and are entitled to distribution. After final distribution, the interest of any stockholder who has not proved his interest is forever barred and foreclosed.

(d) **Unclaimed assets.** - (a) Any assets remaining unclaimed 60 days after the final distribution, whether through failure or inability of the postal authorities to deliver the distribution checks or for any other reason is presumed abandoned and shall be reported to the abandoned property unit of the State Comptroller's office in accordance with Title 17 of the Commercial Law Article, the Maryland Uniform Disposition of Unclaimed Property Act.

(2) The director-trustees or

receiver are released and discharged from all further liability in the matter on payment or delivery of all unclaimed assets to the abandoned property unit of the State Comptroller's office. (An. Code 1957, art. 23, Section 83; 1975, ch. 311, Section 2; 1976, ch. 387, Section 1; 1977, ch. 529.)

# APPENDIX J

**Rule 19. Joinder of Persons Needed for Just Adjudication.**

(a) PERSONS TO BE JOINED IF FEASIBLE. A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring double, multiple, or otherwise inconsistent

obligations by reason of the claimed interest. If the person has not been so joined, the court shall order that the person be made a party. If the person should join as a plaintiff but refuses to do so, the person may be made a defendant, or, in a proper case, an involuntary plaintiff. If the joined party objects to venue and joinder of that party would render the venue of the action improper, that party shall be dismissed from the action.

(b) DETERMINATION BY COURT WHENEVER JOINDER NOT FEASIBLE. If a person as described in subdivision (a)(1)-(2) hereof cannot be made a party, the court shall determine whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent person being thus regarded as indispensable. The factors to be considered by the court include;

first, to what extent a judgment rendered in the person's absence might be prejudicial to the person or those already parties; second, the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; third, whether a judgment rendered in the person's absence will be adequate; fourth, whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder.

(c) PLEADING REASONS FOR NONJOINDER. A pleading asserting a claim for relief shall state the names, if known to the pleader, of any persons as described in subdivision (a)(1)-(2) hereof who are not joined, and the reasons why they are not joined.

(d) EXCEPTION OF CLASS ACTIONS. This rule is subject to the provisions of Rule 23.

# APPENDIX K

**Federal Rules of Civil Procedure**
**Rule 23(e)**

**Rule 23. Class Actions.**

(e) DISMISSAL OR COMPROMISE. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

# APPENDIX L

**Rule 26. General Provisions Governing Discovery.**

(c) PROTECTIVE ORDERS. Upon motion by a party or by the person from whom discovery is sought, and for good cause shown, the court in which the action is pending or alternatively, on matters relating to a deposition, the court in the district where the deposition is to be taken may make any order which justice requires to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense, including one or more of the following: (1) that the discovery not be had; (2) that the discovery may be had only on specified terms and conditions, including a designation of the time or place; (3) that the discovery may be had only by a method of discovery other than that

selected by the party seeking discovery; (4) that certain matters not be inquired into, or that the scope of the discovery be limited to certain matters; (5) that discovery be conducted with no one present except persons designated by the court; (6) that a deposition after being sealed be opened only by order of the court; (7) that a trade secret or other confidential research, development, or commercial information not be disclosed or be disclosed only in a designated way; (8) that the parties simultaneously file specified documents or information enclosed in sealed envelopes to be opened as directed by the court.

If the motion for a protective order is denied in whole or in part, the court may, on such terms and conditions as are just, order that any party or person provide or permit discovery. The provisions of Rule 37(a)(4) apply to the

award of expenses incurred in relation to the motion.

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FILED
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(3)

No. 89-924

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1989

DAVID P. GOULD, et al.,

Petitioners,

v.

ALLECO, INC., et al.,

Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

# BRIEF OF RESPONDENTS LEONARD AND PATRICIA ROBINSON IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED FOR REVIEW

This Petition concerns the settlement of a securities fraud class action suit brought on behalf of purchasers of the common stock of Allegheny Beverage Corporation during the period May 14, 1985 through June 30, 1986 (*Robinson* litigation). Petitioners, holders of debentures of the corporation, objected to the settlement and attempted to intervene in the *Robinson* litigation. The District Court denied the motion to intervene, held that Petitioners had no standing to object and approved the settlement. The Court of Appeals for the Fourth Circuit affirmed.

The Petition presents two questions for review. They are as follows:

1. Did the District Court err in holding that Petitioners, who were not members of the class, had no standing to object to the settlement?

2. Did the District Court abuse its discretion in denying Petitioners' motion to intervene in the *Robinson* litigation?

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**BRIEF OF RESPONDENTS LEONARD AND PATRICIA ROBINSON IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI**

Pursuant to Rule 22 of the rules of this Court, Respondents, plaintiff class representatives in the Courts below, file this brief in opposition to the Petition for a Writ of Certiorari which seeks to overturn a decision of the Court of Appeals for the Fourth Circuit. It is requested that this Court deny the Petition for a Writ of Certiorari.

## STATEMENT OF THE CASE

In their complaint, filed on July 23, 1986 in the United States District Court for the District of Maryland, Leonard and Patricia Robinson sought to maintain a class action on behalf of all persons who purchased the common stock of Allegheny Beverage Corporation ("Allegheny")[1] from May 14, 1985, to June 30, 1986. The complaint alleged that plaintiffs and the class sustained damages as a result of Allegheny's fraudulent misconduct in violation of §10(b) of the Securities Exchange Act, Rule 10b-5 promulgated thereunder, and common law principles of fraud and deceit. *Robinson v. Allegheny Beverage Corporation* (hereinafter *Robinson*).

After the disposition of numerous motions, completion of extensive discovery, and the successful consummation of long-term, arms-length settlement negotiations, the parties, on May 17, 1988, entered into a Stipulation of Settlement providing for the payment of $6,950,000 to the class. Judge Frederic Smalkin preliminarily approved the settlement by Order entered the same day and fixed September 6, 1988 as the hearing date to consider the fairness, reasonableness and adequacy of the proposed settlement and the dismissal of the litigation.

In accordance with the May 17, 1988 Order, notice of the hearing date, together with claim and release forms, was mailed to class members on or about June 21, 1988 and a summary notice of the hearing was published in the national edition of the June 28, 1988 *Wall Street Journal*.

Although no class member voiced any objection to the Stipulation of Settlement, Petitioner Lawrence I. Weisman, (hereinafter "Weisman") on August 1, 1988, (the last allowable day), filed an Opposition of Bondholders to the Proposed Settlement.

From the face of his objection, it was clear that Weisman was not a member of the class. By Order dated August 4, 1988, Judge Smalkin invited the filing of responses to the

1. During the course of this litigation, Allegheny Beverage Corporation changed its name to Alleco, Inc.

Weisman objection by any party on or before August 12, 1988. Weisman was to file a reply, if he desired to do so, by August 19, 1988. Plaintiffs and defendants filed their responses on August 12, 1988, pointing out, *inter alia*, that Weisman had no standing to make such an objection. Weisman filed no reply.

On August 15, 1988, Weisman, acting as both an attorney and one of the parties, filed with the United States District Court for the District of Maryland, a complaint consisting of one-hundred two pages and literally thousands of pages of exhibits. The thrust of this complaint, other than the pursuit of a personal grudge against Morton Lapides, Chief Executive Officer of Allegheny, was difficult to ascertain. However, the requested relief seemed to focus on a then-current tender offer for Allegheny stock and a desire to hold Allegheny executives personally liable for a number of claims. *Gould v. Alleco, Inc.* (hereinafter *Gould*).

In addition, on August 15, 1988 a motion for the appointment of a receiver was filed in the *Gould* action. In this motion, as in the *Gould* complaint, there was no request for specific relief addressed to the *Robinson* action or the settlement therein. Nonetheless, in an understandable abundance of caution, Judge Smalkin, on August 24, 1988, notified all parties to both the *Robinson* and *Gould* actions that "[a]ny requests for preliminary injunctive relief pertaining to the proposed *Robinson* settlement" would be heard at the hearing previously scheduled for September 6, 1988.

On Friday, September 2, 1988, a one hundred fifty-five (155) page First Amended Complaint was filed in the *Gould* action. This complaint reiterated, in even more expansive fashion, many of the same charges as the original complaint, with one notable exception. The amended complaint sought to enjoin the *Robinson* settlement (Count XIII).

On Tuesday morning, September 6, 1988, (Monday, September 5 was Labor Day), the parties convened for the long-scheduled hearing on the *Robinson* settlement. To their surprise, they saw, for the first time, the amended *Gould* complaint. Even more egregious was the discovery that on that

very morning, Weisman and two other *Gould* plaintiffs, (Marks, Inc. and Patrick L. Day), had filed, in the *Robinson* action, a Motion for Intervention and Delay of Settlement.

At the hearing on the settlement, counsel for Weisman and the other *Gould* plaintiffs were unable to state whether any of the parties which they represented was a member of the class but, instead, argued that the fact that some of those parties were bondholders gave them standing to challenge the settlement. However, counsel for Weisman and the other *Gould* plaintiffs were totally unprepared to address the issues which had been raised by the flurry of untimely filings.

Further, when the District Court asked counsel for the *Gould* plaintiffs to proceed with respect to any injunctive relief requested in the *Gould* action as it related to the *Robinson* action, they responded that they were not prepared to do so at that time.

The District Court denied the motion to intervene, approved the settlement and mooted the request for injunctive relief in the *Gould* complaint insofar as it related to the *Robinson* settlement. The *Gould* plaintiffs, including Weisman (hereinafter "Petitioners"), appealed these Orders in both the *Robinson* and *Gould* actions.

By opinion dated August 16, 1989, the Fourth Circuit unanimously affirmed the Order of the District Court. It determined that non-class members have no standing to object to a class action settlement pursuant to Federal Rule of Civil Procedure 23(e). In addition, it held that the District Court did not abuse its discretion in finding that Petitioners could not satisfy the "interest" requirement of Federal Rule of Civil Procedure 24(a) and that the motion to intervene was not timely filed in any event. On September 8, 1989 the Fourth Circuit denied a Petition for Rehearing.

## REASONS FOR DENYING THE WRIT

Nothing in the Petition supports the granting of a Writ of Certiorari, and none of the points raised by Petitioners is worthy of review. Far from attempting to delineate the issues

that make this case one of jurisprudential importance, the Petition simply reiterates the arguments raised by Petitioners below concerning the merits of the District Court's denial of the motion to intervene and attempt to object to the Settlement.

First, the Petition raises no important, unsettled questions of federal law. As set forth in the Opinion of the Court of Appeals, the denial of intervention was not based on a controversial or disputed legal standard but rather on the facts of this case. In addition, as noted by the Court of Appeals in its Opinion, cases involving objections to a class action settlement by non-class members "are few".

Second, no conflict among the Circuit Courts of Appeals is presented by the Decision of the Fourth Circuit. No court has ever allowed a non-class member to object to the settlement of a class action pursuant to Federal Rule of Civil Procedure 23(e). Further, there is complete agreement among the courts as to the standards necessary for intervention pursuant to Federal Rule of Civil Procedure 24(a).

Finally, this case clearly is not one in which the Court of Appeals sanctioned a departure from the accepted and usual course of judicial proceedings, and therefore the exercise of the Supreme Court's supervisory power is unwarranted.

## I. THE PETITION RAISES NO IMPORTANT UNSETTLED QUESTIONS OF FEDERAL LAW

The criteria used by both the District Court and the Court of Appeals in determining whether Petitioners should be allowed to intervene in the *Robinson* litigation are so universally accepted that Petitioners do not challenge their use. Even a cursory review of the opinion of the Court of Appeals illustrates that its affirmance of the denial of intervention involved no question of federal law, important or not. As the Court stated, after holding that non-class members are not automatically barred from attempting to intervene in the settlement proceedings of a class action:

> "It is, rather, on the facts of this case upon which our decision rests." (Appendix B-15).

Thus, Petitioners are reduced to arguing that a Petition for Certiorari is appropriate because, based on the facts of this case, the Court of Appeals was wrong in concluding that the District Court did not abuse its discretion when it denied Petitioners the right to intervene in *Robinson*.

The holding, by the Court of Appeals, that non-class members have no standing to object to a settlement of a class action pursuant to Federal Rule of Civil Procedure 23(e) cannot be classified as an important unsettled question of federal law. It is hardly appropriate to term the issue unsettled when not one court has ever accorded a non-class member standing to object to a class action settlement. That this should be the state of the law is not surprising. As was stated by the Eighth Circuit in *Jenson v. Continental Financial Corp., 591 F.2d 477, 482 n. 7 (8th Cir. 1979):*

> The trustees for the bankrupt also contend that Fed.R.Civ.P. 23(e) requires that the security interest be voided as detrimental to the rights of the general creditors of the bankrupts and of the former class members who chose to opt out and maintain their own action. The purpose of Rule 23(e), which prohibits class actions from being dismissed or compromised without court approval, is to protect the rights and interests of absent class members. Opt-outs and general creditors are not members of the class and hence are not entitled to the protection of Rule 23(e). Wright & Miller, *Federal Practice and Procedure*, §1797 (1977); Norman v. McKee, 431 F.2d 769, 774 (9th Cir. 1970); Kusner v. First Pennsylvania Corp., 74 F.R.D. 606 (E.D. Pa. 1977), aff'd. 577 F.2d 726 (3rd Cir. 1978).

Further, the question is clearly not important. Cases where non-class members attempt to object to class action settlements are, fortunately, few. In addition, given the fact that such people can, if they meet the requirements of Federal Rule of Civil Procedure 24(a), intervene and protect their interests, there is obviously no importance to the question or widespread impact from the decision.

Accordingly, the Petition presents no important unsettled questions of federal law.

## II. NO CONFLICT AMONG THE CIRCUITS IS PRESENTED BY THE PETITION

Given the fact that intervention under Federal Rule of Civil Procedure 24(a) was denied on the facts of this case rather than on an issue of law, there can be no argument that the decision of the Court of Appeals on this issue is in conflict with the decision of any other Circuit.

Although it is not clear, Petitioners' memorandum seems to suggest that the decision of the Fourth Circuit is in conflict with cases decided by three other Circuits. However, a review of each of these cases illustrates that it is inapposite or, in actuality, supports the conclusion that non-class members have no standing to object to a class settlement under Federal Rule of Civil Procedure 23(e). In *In re The Pittsburgh and Lake Erie Railroad Company Securities and Antitrust Litigation*, 543 F.2d 1058, 1067 (3rd Cir. 1976), Irving Trust Company objected, as a pledgee of stock, to the settlement of a series of class shareholder derivative actions. The Third Circuit, in holding that Irving had standing to object, emphasized Irving's status as a pledgee which has the same ability to protect its equity as does any holder of stock, including its own pledgor:

> "It is the general rule, as well as the generally preferred view, that a pledgee of stock, whether or not that stock has been registered in the pledgee's name on the books of the corporation, has the same right to protect his stockholder's equity as does a pledgor . . .the only sound federal rule is that a pledgee of stock has standing both to assert a Rule 23.1 derivative claim and to object to a settlement of that claim."

Thus, it was Irving's status as someone who "stood in the shoes" of a class member which gave it standing to object to the class settlement.

In *Piambino v. Bailey*, 757 F.2d 1112 (11th Cir. 1985), a

class action had been brought by purchasers of distributorships of a nationwide pyramid marketing scheme. At or about the time of the instigation of the class action lawsuit, the class members located in California became the beneficiaries of a multi-million dollar state court judgment obtained by the California Attorney General. Pursuant to that judgment, a trustee, (David Sylva), was appointed to administer the fund. Subsequently, activities in the class action and its eventual settlement adversely affected the payments to be made into the California Fund. Under these circumstances, in a decision of the Court of Appeals previous to the one cited by Petitioners, Sylva was held to be a real party in interest pursuant to Federal Rule of Civil Procedure 17(a), and to have standing to challenge the settlement. *Piambino v. Bailey*, 610 F.2d 1306 (5th Cir. 1980). Unlike the case *sub judice*, Sylva was representing the interests of members of the class who had conflicting interests with Lead Counsel and other class members. Here, Petitioners are not members of the class and can make no such claim.

Finally,[2] in *In re Equity Funding Corporation of America Securities Litigation*, 603 F.2d 1353 (9th Cir. 1979), Petitioners point to the fact that debenture holders were held to have standing to object to the settlement therein. What they do not seem to understand is that there existed in that litigation a class of debenture holders whose class representatives objected to the plan of allocation set forth in the proposed settlement. *It was as members of the class whose claims were being settled that debenture holders had standing.*

Accordingly, the Petition presents no conflict between the Circuits requiring a resolution.

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2. *SEC v. Flight Transportation Corp.*, 699 F.2d 943 (8th Cir. 1983), also cited by Petitioner, was decided under Federal Rule of Civil Procedure 24(a) based on the factual record present therein. It is not suggested by Petitioners that the standards for intervention enunciated by the Eighth Circuit were in conflict with those set forth by the Fourth Circuit in the case *sub judice*.

## III. THE FOURTH CIRCUIT DID NOT SANCTION A DEPARTURE FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS

No exercise of this Court's supervisory powers is called for in this case because, as the Fourth Circuit recognized, the District Court treated the Petitioners' objection and motion to intervene in a thorough and altogether appropriate manner.

Respondents believe that the District Court properly considered Petitioners' arguments; found that they had no standing to object to the settlement; that, based on the facts *sub judice*, intervention was inappropriate; and that the settlement should be approved without delay. Petitioners disagree. However, Petitioners' reargument in this Court of the merits of those decisions can in no way cast suspicion on the District Court's conduct of the hearing or its ultimate decisions.

The District Court was faced with a determined attempt to derail a significant settlement of a hard-fought securities class action by non-class members. As the record illustrates, from the outset, the District Court gave Petitioners every chance to substantiate their position. They consistently refused to do so. For example, despite the fact that the motion to intervene was not filed until the morning of the settlement hearing, the District Court afforded Petitioners the opportunity to illustrate their right to intervene, as can be seen by the following colloquy which appeared at pages 8 through 10 of the hearing transcript:

> THE COURT: All right. Tell me how the bondholder has standing to intervene then, because I certainly don't think the law tolerates people who are members of the same class coming in in a disorderly fashion to interrupt a settlement proposal as to which they have plenty of time to file orderly objections and exceptions, and you can't have two classes at the same time. The law will not permit that under Rule 23. Gould has not been certified, and to the extent they seek certification and they represent exactly the same class, the law will not tolerate two

class actions being litigated at the same time by different attorneys for the same class, not that I have ever seen.

MR SCHMIDT: I think you are correct, but with respect to bondholders I believe we have a separate position.

THE COURT: How do the bondholders have standing to challenge the settlement?

MR. SCHMIDT: The bondholders have claims which under the complaint would exceed the amount of the Alleco funds available.

THE COURT: Exceeds the amount of the Alleco funds available? What are you talking about?

MR. SCHMIDT: The bondholders' standing has to do with a competitive claim in the property before the Court, that is, the settlement funds and the total funds of Alleco, Incorporated, and bondholders seeking to intervene to protect what would be a superior claim.

THE COURT: Have you found any law that recognizes the right of a creditor or the holder of a debt instrument, which is basically a creditor, to intervene with regard to a proposed class action shareholder suit settlement?

MR. SCHMIDT: Within the limited time available I believe we have pointed to the Court at least two cases reflecting the general principle that if you have a readily identifiable interest in the funds—

THE COURT: That is not the question I asked you. This is not in rem litigation. I asked you if you have any authority that recognizes the right of a creditor, whether trade creditor or general creditor or holder of a debt, to intervene with regard to a settlement of a shareholder class action.

MR. SCHMIDT: Your Honor, I believe the principle applicable applied in the two cases cited to the Court would apply to that situation as well.

THE COURT: What are the facts of those two cases?

MR. SCHMIDT: I am not positive. I have not had a chance to read them over the weekend.

THE COURT: Anything else you want to say?
MR. SCHMIDT: No, Your Honor.

## CONCLUSION

Petitioners have not even attempted to demonstrate an important issue of unsettled federal law, a conflict between the Circuits, or a departure from the accepted and usual course of judicial proceedings. As the foregoing memorandum illustrates, if Petitioners had attempted to do so, they would have failed. Accordingly, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit**

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## RESPONDENT ALLECO INC.'S BRIEF IN OPPOSITION

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## QUESTION PRESENTED

Whether the district court abused its discretion in rejecting as untimely and not otherwise within the requirements of Rule 24(a), Fed. R. Civ. Pro., a last minute motion to intervene and block a settlement in a long-standing shareholder class action against a company (1) when the movants offered no adequate justification for their utterly untimely filing; and (2) when their only interest was the mere possibility that they might recover a judgment against the company on a complaint later dismissed by the district court.

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## STATEMENT

1. *The Robinson Shareholder Litigation.* In July 1986, Leonard and Patricia Robinson filed a class action complaint against Alleco Inc. (then Allegheny Beverage Corporation) and five of its officers and directors, alleging violations of the federal securities laws and common law fraud and seeking damages on behalf of all persons who had purchased Alleco common stock between May 14, 1985, and June 30, 1986. App. 2324 (hereafter the "*Robinson* case").[1] After nearly two years of extensive discovery and other proceedings, the parties reached a settlement agreement providing for the payment of $6.95 million to the plaintiff class. On May 17, 1988, the district court gave preliminary approval to the agreement; certified the class for settlement purposes; ordered that all members of the class be notified; set a deadline of August 1, 1988, for class members to object to the proposed settlement; and scheduled a fairness hearing for September 6, 1988. Pet. App. B 5-6.

On August 1, 1988, petitioner Lawrence I. Weisman filed an "opposition" to the proposed settlement. Weisman, who did not purport to be a class member, claimed to be the owner of certain 9½ percent Alleco bonds and alleged that the proposed settlement would somehow violate the Indenture pursuant to which his bonds were issued. App. 2412. Two weeks later, on August 15, 1988, Weisman, acting as his own attorney, filed on behalf of himself and five others a complaint against Alleco and thirty-three individuals and entities. Pet. App. B 6-7 (hereafter the "*Gould*" case).

2. *The Robinson Settlement Hearing.* On the morning of September 6, 1988, only minutes before the settlement

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[1] "App." refers to the Joint Appendix in the court of appeals.

hearing in *Robinson*, Weisman and two other plaintiffs in *Gould* (Marks, Inc. and Patrick L. Day), filed a motion to intervene in the *Robinson* lawsuit. Pet. App. B 7.[2] Their motion incorporated their amended *Gould* complaint by reference and argued that they had an interest in the *Robinson* case because the proposed settlement would decrease the funds available to them if they ultimately prevailed in their lawsuit against Alleco.

Counsel for the movants claimed that Weisman was seeking to intervene in his capacity as an Alleco bondholder and a plaintiff in *Gould*, while his two co-movants (Marks and Day) were appearing as Alleco shareholders and plaintiffs in *Gould*. App. 2659. With respect to the shareholder movants, counsel at first seemed to concede that they were members of the class certified in the *Robinson* case. App. 2664. (Although all class members had received notice, none had lodged an objection to the proposed settlement.) Counsel later told the court that he was not certain whether Marks and Day were members of the *Robinson* class because he did not know when they purchased their shares. App. 2674.[3] Weisman, he said, was in any event in a different position because he was not a shareholder and sought to intervene in his capacity as an Alleco bondholder. Upon the district court's inquiry, however, he could not explain why the bondholders' Trustee had not appeared if the proposed *Robinson* settlement was, as Weisman alleged, against the bondholders' interests. App. 2667.

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[2] At the same time, Weisman served an amended complaint in *Gould*. *Id.*

[3] He agreed that the class alleged in *Gould* was the same as that certified in *Robinson* and that there could not be two identical classes at the same time. App. 2664.

As to the basis for intervention, movants' counsel admitted that he did not "know most of the underlying facts" (App. 2661). He nevertheless requested the court to grant intervention and cancel the *Robinson* settlement hearing in order to permit the movants to "demonstrate that their claims [in *Gould*] are sufficiently substantial" (App. 2710, 2716-17) and to give them an opportunity to provide the court with authority for their intervention (App. 2666), which counsel was unable to do at the hearing because he had not read the cases that supposedly supported their position. App. 2666.

3. *The Decision of the District Court.* The district court denied the motion to intervene. The court ruled that the motion was "utterly untimely" under Rule 24(a)(2), Fed. R. Civ. Pro., and would "not be tolerated." App. 2678-79. The hearing had been set for months and the court found that Weisman knew this full well. App. 2678-79. Yet the motion to intervene was not filed until the morning of the hearing and even then the movants had made no "strong showing either of likelihood of success in bringing about disapproval of the proposed settlement or of any recognized harm that the law will protect being invaded by the proposed settlement." App. 2678.

In the alternative, the court ruled that a contingent interest in some future recovery against Alleco—the only ground asserted in support of intervention—was insufficient for intervention as of right. App. 2677-82. Movants' counsel had failed to cite any authority in support of an opposite conclusion and the court rejected counsel's claim that he needed more time to research the law. App. 2679-80.

With respect to the objection Weisman had filed on August 1, 1988, the court held that he was not a member

of the *Robinson* class and therefore did not come within the terms of Rule 23(e), which applies only to class members.

4. *The Decision of the Court of Appeals.* The court of appeals affirmed. The court held that under Rule 24, intervention motions must be timely filed and that the motion here did not comply with that requirement. Pet. App. B 19. The court considered how far the *Robinson* case had progressed when the motion was filed, the prejudice to the parties and the reason for the "tardiness in moving to intervene." *Id. Robinson* had involved "[t]wo years of extensive litigation and settlement negotiations [which] culminated in the settlement proposal presented to the court on May 17, 1988." Pet. App. B 20. But the motion to intervene was not filed until "[t]hree and one-half months later, at the last possible moment . . ." *Id.* In addition, the effect of intervention and the consequent delay in approval of the settlement would have reduced the value of the fund available to the class members. Pet. App. B 23. Finally, the movants had no justifiable excuse for delaying their intervention until the morning of the hearing. Pet. App. B 24.

Apart from petitioners' failure to satisfy Rule 24's timeliness requirement, petitioners had not demonstrated an adequate interest to permit them to intervene as of right. They had merely claimed "a general interest in Alleco's assets based on a speculative recovery in an unrelated civil action" (Pet. App. B 17).

With respect to Weisman's "objection" to the settlement, the court of appeals held that as a non-member of the settling class Weisman was not within the terms of Rule 23(e), which "clearly contemplates allowing only class members to object to settlement proposals." Pet.

App. B 10. If non-class members wish to protest, they must file timely and proper motions to intervene. Pet. App. B 11. "[N]on-class members have no standing to object, pursuant to a Rule 23(e) notice directed to class members, to a proposed class settlement." *Id.*

5. *Proceedings in the Gould Case.* On September 19, 1988, the district court granted defendant's motion to dismiss the *Gould* complaint on the ground that it violated Rule 8(a), Fed. R. Civ. Pro. Pet. App. B 8 n.2. Alleco then moved for sanctions and injunctive relief against Weisman because he had served as an attorney for the company and its chief executive officer during the period encompassed in the *Gould* complaint, because in the *Gould* complaint he falsely declared under oath that he had not had such an attorney-client relationship, and because the complaint alleged matters within that relationship. App. 2166.

After an evidentiary hearing on February 27, 1989, while this case was awaiting decision by the court of appeals, the district court found that Weisman's misconduct as an attorney had been egregious, that his complaint in *Gould* was falsely sworn and that he had engaged in bad faith in bringing the *Gould* action. The district court dismissed Weisman as a plaintiff in *Gould* with prejudice and enjoined him from using or disclosing information within the attorney-client relationship. Order of Feb. 28, 1989, No. S 88-2399 (D. Md.). With respect to the other plaintiffs in *Gould*, the court dismissed their complaint without prejudice and placed restrictions on their use of any information disclosed to them by Weisman in connection with the *Gould* complaint. *Id.*

Weisman appealed from the court's Rule 11 judgment against him. The other *Gould* plaintiffs, including Marks and Day, did not appeal; with respect to them, the district

court's judgment dismissing their complaint therefore became final.

## ARGUMENT

The decision below does not warrant review. No recurring issue is presented. No question of general importance has been raised. The judgment does not create any conflict among the courts of appeals. The decision rested "on the facts of this case" (Pet. App. B 15) and the court of appeals correctly applied settled law to those facts in ruling that the district court had not abused its discretion in rejecting petitioners' motion to intervene. Still other considerations render the case even less worthy of further consideration.

1. Of the three parties who sought to intervene for the purpose of blocking the settlement in *Robinson*, two are no longer in any position to raise questions regarding the decision below. Marks, Inc. and Patrick L. Day moved to intervene on the ground that payment of the settlement might impair their ability to collect any future judgment they might recover on their complaint in *Gould* (Pet. App. B 17; App. 2709-10). However, as set forth above, the district court later dismissed the *Gould* complaint, neither Marks nor Day appealed from the district court's judgment against them (*see Torres* v. *Oakland Scavenger Co.*, 108 S. Ct. 2405 (1988)), and they have no outstanding complaint against Alleco.

2. With respect to the remaining party—Lawrence I. Weisman, the district court also later dismissed, with prejudice, his complaint in *Gould* as a sanction for Weisman's false declaration under oath and his violation of Rule 11, Fed. R. Civ. Pro. Unlike Marks and Day, however, Weisman has appealed from this judgment. His appeal is currently pending. If Weisman loses that appeal, the questions he presents here will also become moot

because, like his co-movants, his intervention motion rested on his status as a plaintiff in *Gould*.

3. Weisman, who claims to be a bondholder, purports to be acting on behalf of a class of "bondholders" (*e.g.*, Pet. 7, 9, 14). That is not accurate. The intervention motion was not filed as a class action and no such class was ever certified.

Moreover, Weisman was barred by the "no action" clause in the Indenture not only from acting on behalf of other bondholders, but also from instituting any legal action to enforce his alleged rights as a bondholder. The Indenture provides that the Trustee has the duty to bring suits to protect the bondholders' interests; only if the Trustee refuses to do so, upon the request of the holders of 25 percent or more of the outstanding bonds, can those individual bondholders institute legal proceedings. App. 2424-25; Pet. App. D 47-48. Here neither the Trustee nor the holders of 25 percent of the bonds sought to intervene in the *Robinson* case.

Without more, the fact that the Indenture barred Weisman from bringing the *Gould* suit and from seeking to intervene in the *Robinson* case in his capacity as a bondholder disposes of his contentions in this Court. Although this issue, which is governed by state law, was raised below (App. 2424-25; Br. of Defendants-Appellees, at p. 21)), the court of appeals ruled against Weisman without having to reach it.[4]

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[4] Invoking Maryland corporate law, the federal bankruptcy code, unidentified Indenture provisions, and decisions concerning other subjects, petitioners seek to create the impression that bondholders such as Weisman had to look to Alleco alone for payment of the interest and principal on their bonds and that Weisman should have been permitted to intervene because the settlement in *Robinson*

4. The first two questions presented (Pet. i) are directed to the ruling of the court of appeals that petitioners, in moving to intervene, failed to satisfy the requirements of Rule 24(a).[5] As we have indicated, the questions are fact-intensive and involve no unsettled legal principles about which the courts of appeals are in disagreement. For those reasons alone, further review is unwarranted.

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prevented Alleco from meeting these obligations. Pet. 26. Apart from the fact that petitioners did not raise these arguments in the district court, they are not accurate.

Alleco sold its assets in December 1987 to Service America Corporation, which assumed all the obligations under the Indenture and has since made all interest payments on the bonds and has otherwise fully complied with the terms of the Indenture. *See Sharon Steel Corp.* v. *Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1051 (2d Cir. 1982), *cert. denied*, 460 U.S. 1012 (1983) (recognizing the importance of successor obligor provisions in indentures allowing companies such as Alleco "to liquidate their operating assets and enter a new field free from public debt"). It is true that a federal district court in Minnesota ruled in August 1989 that a technical breach of the Indenture occurred (Pet. App. D 1), but that decision in favor of the Trustee has no bearing whatever on the question whether Weisman's intervention motion should have been granted a year earlier, in September 1988. In any event, the Minnesota court's decision has been appealed.

Weisman also suggests that as a bondholder, he was entitled to block the tender offer, merger and dissolution of Alleco (Pet. 16, 31). How that relates to his intervention motion in the *Robinson* case he does not explain. In any event, he neglects to point out that the Trustee, on behalf of *all* bondholders, sought a preliminary injunction to stop these transactions and the Minnesota district court denied it. Pet. App. D 11-12.

[5] The remaining two questions are directed at the alleged terms of the *Robinson* settlement. Pet. i-ii. Because petitioners' motion to intervene was properly denied, the court of appeals did not reach these questions and we do not discuss them in this opposition.

In any event, the court of appeals correctly held that the motion to intervene was "outside even the most indulgent standard of timeliness" and was therefore properly denied for that reason (Pet. App. B 18-25). The *Robinson* litigation had been going on for years. The September 6, 1988, hearing on the proposed settlement had been scheduled months ahead of time. As the district court found, Weisman knew of the upcoming hearing in the *Robinson* case well in advance, but chose to file his motion to intervene at the last possible moment, only minutes before the hearing commenced. Pet. App. B 5, B 7.

His sole excuse for this utter disregard of the orderly procedure mandated by the district court was that he had been ill. But as the court of appeals held, the district court properly rejected that excuse, which was belied by the fact that throughout the month before the hearing, Weisman had been inundating the court with massive pleadings in his role as an attorney for himself and other other plaintiffs in *Gould*. Pet. App. B 24. Moreover, Weisman was represented by counsel and his alleged personal medical problems, which were never substantiated at the hearing, did not incapacitate his numerous attorneys. *Id.*

In light of these and other circumstances (Pet. App. B 19-B 23), the district court properly denied the intervention motion. "Timeliness is to be determined from all the circumstances" and "the court's ruling will not be disturbed on review" unless there has been an abuse of discretion. *NAACP* v. *New York*, 413 U.S. 345, 366 (1973); *see* Shapiro, *Some Thoughts on Intervention Before Courts, Agencies, and Arbitrators*, 81 Harv. 721, 759 (1968). The court of appeals correctly applied these settled principles and its decision presents no issue worthy of further consideration.

5. As an independent ground for sustaining the district court's denial of intervention, the court of appeals correctly ruled that the petitioners had not satisfied Rule 24(a)(2)'s requirement that the applicant demonstrate a sufficient interest in the action.[6] Petitioners merely claimed that if they were ultimately successful in their action in *Gould* (which they were not), payment of the settlement in *Robinson* would leave less money for them. Pet. App. B 17. But if that were a sufficient basis for intervention as of right under Rule 24, "every proposed settlement would be subject to derailment as long as a potential judgment creditor decided to intervene." Pet. App. B 17. *See, e.g., Hawaii-Pacific Venture Capital Corp.* v. *Rothbard*, 564 F.2d 1343, 1346 (9th Cir. 1977); *Kusner* v. *First Pennsylvania Corp.*, 74 F.R.D. 606, 609-11 (E.D. Pa. 1977), *affirmed*, 577 F.2d 726 (3d Cir. 1978).[7] Accordingly, the district "court did not abuse its

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[6] Weisman does not contend that he was a member of the class entitled to notice and an opportunity to be heard regarding the settlement under Rule 23(e). His claim instead is that Rule 24(a) applies to fairness hearings on settlements in class actions (Pet. 18), a point about which the court of appeals agreed. The decision below turned, as we have discussed, on petitioners' failure to satisfy the requirements of Rule 24.

[7] *Securities and Exchange Comm'n* v. *Flight Transp. Corp.*, 699 F.2d 943 (8th Cir. 1983), which petitioners cite, is not to the contrary. The decision turned on its peculiar facts. The court of appeals recognized that generally potential creditors must bring their own actions and cannot intervene in an action brought by another creditor. 699 F.2d at 947. The court of appeals ruled, however, that a potential creditor of Flight Transportation should have been allowed to intervene because the district court had issued an injunction in the case preventing it from prosecuting its own, independent action against the company. 699 F.2d at 947-948. No such injunction had been issued here. Petitioners were free to prosecute their *Gould* complaint and did so—unsuccessfully. These and other factors set forth in the text fully supported the district court's denial of intervention.

discretion by ruling that the intervenors had an insufficient interest for Rule 24(a) purposes." Pet. App. B 18.

## CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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